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No. 54

In the

# Supreme Court of the United States

OCTOBER TERM, 1963

UNITED STATES OF AMERICA,

*Petitioner,*

*v.*

DOROTHY ANNE STAPP AND B. T. WARE, II, EXECUTORS AND TRUSTEES OF THE ESTATE OF LOWELL H. STAPP, DECEASED, AND DOROTHY ANNE STAPP, INDIVIDUALLY,

*Respondents.*

## RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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No. 733

In the

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OCTOBER TERM, 1962

UNITED STATES OF AMERICA,
*Petitioner,*

*v.*

DOROTHY ANNE STAPF AND B. T. WARE, II,
EXECUTORS AND TRUSTEES OF THE ESTATE
OF LOWELL H. STAPF, DECEASED, AND
DOROTHY ANNE STAPF, INDIVIDUALLY,
*Respondents.*

## RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Respondents, DOROTHY ANNE STAPF and B. T. WARE, II, Executors and Trustees of the Estate of Lowell H. Stapf, Deceased, and DOROTHY ANNE STAPF, individually, file this opposing brief in opposition to the petition of the United States of America, petitioner, for a writ of certiorari to review the judgment of the Court of Appeals in this case.

## OPINIONS BELOW

The opinion of the District Court (R. 53-80) (R. will be hereafter used to refer to printed Transcript of Record filed in the Court of Appeals) is reported at *189 Fed. Supp. 830*, and is copied herein (App. 46a to 71a) (App. refers to the Appendix to this brief). The opinion of the Court of Appeals is now reported at *309 Fed. 2d 529* (App. 6a to 45a).

## JURISDICTION

Respondents do not deny or question the jurisdiction of this Court as invoked by petitioner, but respondents submit that in the exercise of sound judicial discretion a writ of certiorari should be denied under Rule 19 of this Court.

## QUESTIONS PRESENTED

Respondents submit that the first question presented in the petition is more accurately stated as below stated, but that the second question as presented in the petition and copied below is a fair statement of such question. Accordingly, respondents would state the questions presented as follows:

1. Should the agreed value of property passing to the surviving spouse under the will of the decedent and qualifying for the marital deduction be reduced to zero in determining the estate tax liability of the decedent's estate because the surviving spouse elected, as she was authorized to do under the decedent's will, to permit the passage to trustees of testamentary trust for the benefit of children of decedent, of an undivided interest in a part of her share

of the community property that was fully vested in her which was of a greater value than the property passing under the will to the surviving spouse?

2. Whether claims against the community estate for which the wife's half of community property is equally liable but which the decedent's will directs to be paid entirely from his half are deductible in full from the decedent's gross estate as "claims against the (decedent's) estate" within the meaning of § 812(b) of the Code.

## STATUTES AND REGULATIONS INVOLVED

Sections 812(b) and 812(e) of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.), and §§ 81.36, 81.47a, and 81.47c of Treasury Regulations 105 are set forth in part in App. A, infra, pp. 1a to 5a.

## STATEMENT

The brief statement in the petition, though modified as to actual figures for simplicity, is not an incorrect statement except to the extent that it is stated or implied that any portion of the community property, other than the decedent's ½ community fee in the family automobile, passed to the surviving spouse under decedent's will. Under the law of Texas, as recognized by the Court of Appeals and as is recognized in the petition (Note 6, page 5 of petition) the only portion of the decedent's estate that passed to the surviving spouse under the decedent's will was a ⅓rd interest in decedent's separate property (and a ½ community property interest in the automobile) valued at

$20,000.00. The total of $106,000.00 in assets held by the surviving spouse after her election consisted of the ⅓rd interest in decedent's separate property and his ½ community interest in the family automobile of the aggregate value of $20,000.00 and $86,000.00 of her share of the community property, which was satisfied out of the surviving spouse's ½ share of the total community estate already owned by her and which did not pass from the decedent to her.

## REASONS FOR REFUSING THE WRIT

No claim is made by petitioner that the decision of the Court of Appeals is in conflict with the decision of another Court of Appeals or of this Court. In fact, no decisions from any Court are cited as being contrary to the decision below.

Petitioner attacks the decision of the Court of Appeals, primarily on the grounds, that if effect is given to the clear and express provisions of the Statutes here involved (Sections 812(b) and 812(e) of the Internal Revenue Code of 1939) as was done by the Court of Appeals, petitioner has fear that less taxation revenue, than that which petitioner thinks would be otherwise collected, would result. This, of itself, is not a proper basis for seeking relief here, nor does this contention by petitioner warrant or present grounds for this Court to construe a Statute, contrary to its terms, in order to prevent possible revenue loss. If changes in the Statutes of the character desired by petitioner are needed, then petitioner's request therefor should be presented to Congress and not here.

## I. THE MARITAL DEDUCTION

The sole question presented with respect to the marital deduction issue is the application of Section 812(e)(1)(E)(ii) of the Internal Revenue Code of 1939 in valuing specific property passing absolutely to the surviving spouse and no one else, and clearly qualifying for the marital deduction.

The question of the liability, or the amount of liability, of the surviving spouse for gift taxes with respect to that portion of her community property ($25,000) passing from her to the Trustees for the children of the decedent and the surviving spouse, as a result of her election to take under the will, is not presented and has never been presented in this case.

Mrs. Stapf does not now and has never denied the gift tax consequences to her with respect to the passage of the 1/6th share of the community property (which came out of her ½ of the total community) to the trust as a result of her election to take under the will. This, however, is a separate transaction or occurrence from the passage of specific property to Mrs. Stapf under the decedent's will, and has tax consequences entirely separate from the issue here involved. A determination of the issue in dispute relating to the marital deduction would not determine the surviving spouse's gift tax liability, and whether she, the surviving spouse, would be entitled to "net" what she gave and what she received in determining such gift tax liability, which possibility is obviously the basis of petitioner's concern in

loss of possible revenue, is not presented for decision. Even if the Gift Statute permits such "netting", and a loss of revenue results, such fact would not justify or authorize a disregard of the clear and explicit provisions of the Estate Tax Statutes, including the marital deduction provisions, in determining the liability of the decedent's estate for estate taxes, as the Regulations and petitioner's contentions would do.

If petitioner's contention were to be sustained, the result would be to tax twice, for estate tax purposes, that which Congress, by the enactment of the marital deduction provision, has said should be taxed only once. This result would follow from refusing to exclude from decedent's estate, under the marital deduction provisions, the $20,000.00 of separate and community property of the decedent passing under decedent's will to his surviving spouse, thereby taxing such property in the decedent's estate and again taxing the same property in the estate of the surviving spouse upon her death. This fallacy in the contention of the petitioner was recognized by both the trial court and the Court of Appeals in their respective opinions as being contrary to both the intent and the express provisions of the marital deduction section.

The petitioner's contention, advanced under paragraph 1, pages 6, 7 and 8 of the petition, that ⅓rd of the decedent's separate property and his ½ interest in the community owned automobile (of a total value of $20,000.00), instead of passing to the surviving spouse, theoretically or imaginarily passed to the Trustees for the benefit of third par-

ties, is contrary to the provisions of the will, the actualities involved and the decision below.

The petitioner's incorrect construction of the Court of Appeals opinion on pages 7 and 8 of the petition is an unwarranted extension of the decision, and even goes far beyond all applications expressed as possible in the dissenting opinion. Contrary to the petitioner's assertion on page 7 of the petition, the decision below does not destroy the marital deduction or permit married persons to escape taxation entirely, regardless of the disposition of the estate, nor does the Court below hold that a testamentary gift to *anyone* may be made to qualify for the marital deduction by the simple device of having it "pass through" the surviving spouse. No such hypothetical situations, based on imagined facts, bearing no semblance of comparison to the present fact situation were presented for consideration and are far afield of any possible ambit of the decision below.

The imaginary example in footnote 9 on page 7 of the petition and the bold assertion on page 7 of the petition that the decision below could be used in non community property states even where the wife had no separate property in such an imagined situation to escape taxation, and the even bolder assertion that so long as there is a surviving wife the decedent can dispose of his property to whomever he pleases without giving anything to his wife and yet get the marital deduction, present fact situations not before the Court, and erroneous conclusions of petitioner not even recognized as being a possibility in the dissenting opinion. In fact, the fears of the dissenting opinion as to the possible

application of the majority opinion would not encompass such a result, for it was there pointed out that the possibilities of loss of taxation revenue as a result of the application of the majority opinion could occur in a common law state "only if the widow had property of her own", App. p. 39a. Additionally, it would appear that in the supposed situation, where the wife had no property of her own, and there was a direction that a payment or gift be made to a third party, such gift would have to be satisfied out of the property passing under the decedent's will and would be a direct charge thereon just as a lien against the property so passing would have to be satisfied out of the property. Such a situation is entirely different than the one here presented and no analogy or conclusion of the kind sought to be drawn by petitioner is proper.

The assertions in paragraph 2 on pages 8, 9 and 10 of the petition to the effect that the opinion below would sanction a testamentary bequest "passing through" the surviving spouse to a third party as qualifying for a marital deduction, or that a testamentary gift of property to someone other than the surviving wife could qualify, under the opinion below, as a marital deduction disregard the facts and misinterpret the holding below.

All the court below held was that $20,000.00 of property belonging to the husband (qualifying for the marital deduction because of his ownership of separate property of greater value) which passed absolutely to the surviving wife under his will was not to be reduced, under the explicit statutory language, to a negative value in determining the

estate tax liability and marital deduction exclusion in the husband's estate simply by virtue of the fact that the wife elected to take under the will and thereby relinquished a part of her community property ($25,000) to a testamentary trust created in the husband's will for the benefit of their children. The property that passed to the wife stopped there and would be subject to estate tax in her estate upon her death. Neither this property nor other property "passed through" the surviving spouse to third parties. Under the applicable law the decision of the court below and the facts there presented, the wife's 1/6th share of the community property, which went to trust for the children, was never a part of the deceased husband's estate and did not pass from him either directly to the children or from him "through" his surviving spouse to the children, as the petitioner would have this Court suppose by petitioner's argument and imaginary illustrations.

The correctness of the opinion below is demonstrated by an examination of the actual facts, the actual holding and the applicable established principles of law without resort to the exaggerated fears of loss of possible taxation revenue which loss, if any, would result solely from application of the Gift Tax Statute, not the testamentary disposition of property included in the decedent's estate, but to the gift of the separately owned share of community property of the surviving spouse, which was never a part of the decedent's estate, and which passed from her to the trust for the children as a result of her election to take under the will which privilege she separately exercised after the death of her husband.

Sections I (R. 12), IV (R. 13 and 14) and XII (R. 21-22) of the will of the decedent make it undeniably clear that the 1/3rd interest of the decedent in his separate property, and his 1/2 interest in the community owned automobile fully vested, without qualification, in the surviving spouse when she elected to take under the will.

Such property ($20,000) so passing to the surviving spouse will be taxed in her estate for estate tax purposes upon her death. Petitioner does not deny this or claim otherwise. Under such circumstances this property clearly qualified for the marital deduction, and the value of the property so passing is not to be reduced to a zero value simply because the surviving spouse effectively made a gift of $25,000.00 of her absolutely owned property to the trust. The property received by her under the will had a value of $20,000.00 in her hands, just as it had a value of $20,000.00 in the hands of the decedent before his death. *The value of the property passing to the surviving spouse did not change.*

Only the decedent's 1/2 part of community property is included in his estate for Federal estate tax purposes, and no part of the surviving spouse's 1/2 share of the community estate is includable in the estate of the first to die for estate tax purposes.

*Commissioner of Internal Revenue v. Chase Manhattan Bank, 5th Cir. 1958, 259 Fed. 2d 231, cert. den. 359 U.S. 913;*

*Pitts v. Hamrick, 4th Cir. 1955, 228 Fed. 2d 486.*

Petitioner does not deny this.

It is equally clear that by electing to take under the will the ½ community interest of the wife is not included in the gross estate of the husband for estate tax purposes, even though the wife's ½ community share, as well as the husband's ½ community share, was disposed of by the will of the husband. This is a long standing principle recognized by the Internal Revenue Service. Any question in this regard was removed in 1930 by the memorandum decision of the General Counsel of the Internal Revenue Service, to-wit: GCM 7773, CB IX-2, page 426, Ruling 33-4750, which refers to Section 302(a) of the Revenue Act of 1926, which is virtually identical, if not exactly identical, to the provisions of the Revenue Act in force at the time of the death of the decedent. The GCM was based upon two cases in the Northern District of Texas, namely, *Vincent v. United States*, and *Underwood v. Reed*. For convenience a copy of Cumulative Bulletin IX-2 reflecting such ruling is included in App. 71a to 72a of this brief. See also *Coffman-Dodson Bank & Trust Co., Executor, 40 B.T.A. 890*, and *The Pacific National Bank of Seattle, Executor, 40 B.T.A. 128*.

It is equally clear that under the established law in Texas, the ⅓rd interest in the total community property provided for Mrs. Stapf under the will did not pass to Mrs. Stapf under the will of Mr. Stapf, and did not become subject to state inheritance tax. This ⅓rd interest ($86,000.00) in community property, retained and owned by Mrs. Stapf after her election, just as it was owned before her election, is satisfied out of the ½ share of community property owned by Mrs. Stapf and *not* out of the decedent's share of the

community property. *Jones v. State, Tex. Comm. of App., 1928, 5 S.W. 2d 973*, and *Calvert, Comptroller, v. Fort Worth National Bank, Tex. Sup. Ct. 1962, 356 S.W. 2d 919, affirming Calvert v. Fort Worth National Bank, Tex. Civ. App., 348 S.W. 2d 19.* This is recognized by Petitioner, page 5, note 6, of petition.

As appears from the opinions of the trial court and the Court of Appeals, the petitioner erroneously contended in those courts that Mrs. Stapf received $106,000.00 under the will and gave up $111,000.00 by her election. All such prior contentions are now apparently abandoned by petitioner and it is recognized by petitioner, page 5 of petition, that only the $20,000.00 in property actually passed to the surviving spouse under the will of the decedent in line with the foregoing authorities and the decision of both the trial court and the Court of Appeals, thus the issue is confined to such $20,000.00 of separate property of the decedent (including the ½ community interest in the family automobile).

We are not here concerned with the requirements of Section 812(e)(1)(H) providing a limitation on the aggregate amount of the marital deduction, since the amount claimed as a deduction (including both the ⅓rd interest in decedent's separate property and his ½ community property interest in the family automobile) is less than 50% of the value of the "adjusted gross estate" as defined in the Statute.

The only controversy that has existed with respect to the marital deduction arises under Section 812(e)(1)(E)(ii) which relates to the valuation of the interest passing to the

surviving spouse. The petitioner would have the Court value the $20,000.00 of property passing to the surviving spouse at zero and thereby deny the marital deduction with respect to such property, though it qualified under all other provisions of Section 812(e) as a marital deduction to be excluded from the decedent's gross estate for estate tax purposes. This indirection, not authorized under Section 812(e)(1)(E)(ii), would completely destroy the marital deduction provided by Congress, and would tax this very property twice by including it in the decedent's net estate and in the surviving wife's estate on her death. Congress has decreed this property should be taxed only once.

Section 812(e)(1)(E) provides:

> "* * * In determining * * * the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection * * * (ii) where such interest or property is encumbered or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest here being determined."

Both the trial court and the Court of Appeals recognized and held the Regulations relied upon by petitioner, Treasury Regulation 105 (1939 Code), Sec. 81.47c(b), to be an unauthorized extension of the Statute insofar as such Regulations attempted to extend such Statute to include an election of the character here involved. Such conclusions are unquestionably correct as the Regulations fail to give effect to the last clause of the valuation statute last quoted to the effect that in valuing the interest to be excluded, the encumbrance or obli-

gation referred to "shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

The legislative intent as expressed in Senate Supp. Report No. 1013, Part 2, 80th Cong., 2nd Sess. page 1163, House Report No. 1274, Part 2, 80th Cong., 2nd Sess. page 1258, also requires such conclusion. Such Statute clearly refers to the net value of the property itself that passes and not to the net benefit to the surviving spouse as claimed by the petitioner. It is apparent that in determining the amount of the marital deduction, only the net value of the property itself, that passes, is to be considered.

It seems clear to the respondents, as determined by the trial court, that the encumbrance or obligation, referred to in the statute and to be taken into account in valuing the property to be excluded, means an encumbrance or obligation on the property such as a lien against the property or debt as distinguished from an obligation or encumbrance in the nature of a condition or option under the election here involved. *Wachovia Bank and Trust Co. v. United States (Ct. of Cl. 1958), 163 Fed. Supp. 832.* The Court of Appeals did not find it necessary to pass upon this contention asserted by respondents, but concluded, as did the trial court, that the last clause of the statute last quoted lays down the formula for determining the valuation, namely, that it shall be taken into account in the same manner as if a gift of such interest by the husband to his wife were being determined.

Applying this test, it cannot be questioned but that, if Mr. Stapf had made an inter vivos gift of his ⅓rd interest in his separate property to Mrs. Stapf upon the condition or based upon her promise to make a gift of 1/6th of her community property to a Trustee for their children, the full amount of the gift from the husband to the wife, unreduced by the amount of the gift by the wife to the trust, would have been a gift or transfer subject to gift tax. *Commissioner of Internal Revenue v. Wemyss, 324 U.S. 303, 89 L. Ed. 958.*

In the case last cited, it was held that a transfer of stock to a prospective bride in consideration of her agreeing to marry the donor, was not a consideration in money within the meaning of the Gift Tax Statute. It was there held, the fact that the prospective bride was not willing to give up the loss of trust income provided for her under a prior trust, which relinquishment would have benefited her son by a prior marriage, unless the gift of stock to her by the prospective groom was made, did not affect the transaction since there was no money consideration benefiting the donor (the prospective groom) as a result of the prospective bride relinquishing to her son her income under the trust from a former marriage. In this connection Mr. Justice Frankfurter, delivering the opinion of the Court, stated:

> "If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. See Commissioner of Internal Revenue v. Bristol (CCA 1st), 121 F(2d) 129. To be sure, the Revenue Act of 1932 does not spell out a requirement of benefit to the transferor to afford relief from the gift

tax. Its forerunner, sec. 320 of the (June 2) 1924 Act, 43 Stat 253, 314 c 234, 26 USCA Int Rev Acts 1940 ed p 81, was more explicit in that it provided that the excess of the transfer over 'the consideration received shall * * * be deemed a gift.' It will hardly be suggested, however, that in re-imposing the gift tax in 1932 Congress meant to exclude transfers that would have been taxed under the 1924 Act. The section taxing as gifts transfers that are not made for 'adequate and full (money) consideration' aims to reach those transfers which are withdrawn from the donor's estate. To allow detriment to the donee to satisfy the requirement of 'adequate and full consideration' would violate the purpose of the statute and open wide the door for evasion of the gift tax. See 2 Paul, supra at 1114."

See also *Commissioner of Internal Revenue v. Bristol, 1st Cir. 121 Fed. 2d 129 at 133; Lowndes and Kramer, Federal Estate and Gift Taxes (1956), pages 739, 740, Sec. 4; Merten's Law of Federal Gift and Estate Taxation, Vol. 1, Page 287, Sec. 5, 11; Estate of John M. Goetchins, 17 T.C. 495; Estate of Koert Bartman, 10 T.C. 1073.*

In the last cited decision *(Estate of Koert Bartman)*, in which the Commissioner of Internal Revenue acquiesced, CB 1948-2, page 1, it was pointed out that the gift tax is an excise tax imposed, not upon the receipt of property by the donee, but upon the act of the donor in making the gift, and that the tax is measured by the value of the property passing. It was held there, among other things, that where a husband gave his children certain property in consideration of their undertaking to pay an annuity to the donor and a contingent annuity to the donor's wife, should she survive, that the value of the annuity to the donor should be deducted

in valuing the property transferred, but no deduction should be made for the annuity undertaken by the donee for the benefit of the wife of the donor who was a third party to the transaction.

Petitioner does not question the accuracy of this Court's opinion in *Commissioner v. Wemyss*, supra, but would like to imagine the Court's holding that the prospective groom in effect made a gift, not to his prospective bride in consideration of her promise of marriage, but to her son by a former marriage. Any such distortion of this Court's holding is completely unjustified under the Court's opinion.

In like manner, petitioner seeks to bypass the *Wemyss* case by asserting the testamentary bequest of the testator of ⅓rd of his personal property and his ½ community interest in the automobile was not a bequest to Mrs. Stapf, but was a devise of property to the Trustees for the benefit of his children. This is simply not correct either in fact or in theory. We are concerned here only with the decedent's ⅓rd interest in his separate property and his ½ interest in the family automobile which, under the indisputable provisions of the will, passed to the surviving spouse absolutely. No part of such property passed to the control of the Trustees for the benefit of their children and the surviving spouse was free to use or dispose of this property in any manner she desired, including testamentary disposition thereof on her death, and such property, if not used or consumed by her during her lifetime, will be a part of her gross estate subject to estate tax upon her death. Mrs. Stapf did not exchange her property with her husband. There was no consideration in money or

money's worth passing to her husband from Mrs. Stapf as would be required under the *Wemyss* decision to reduce the amount of the gift from the donor for gift tax purposes. The estate of the decedent was not augmented by the fact that Mrs. Stapf, by her election, permitted her 1/6th interest in the community property to pass to the Trustees for the children; no consideration in money or money's worth passed to the decedent or the decedent's estate. Even if it be considered that Mrs. Stapf did not make a gift to the Trustees that was subject to gift tax consequences and she permitted testamentary disposition of $25,000.00 of her property to be made by her husband's will, this permission is not a monetary consideration any more than the promise of marriage in the *Wemyss* case, and did not reduce the value of the property that passed to her from Mr. Stapf any more than the value of the stock passing to the prospective bride in the *Wemyss* case was reduced.

The respondents make no contention that the remaining ⅔rds of the separate property of the decedent and his ½ share of the community property (other than his ½ interest in the community owned automobile) are not includable in the decedent's gross estate and are not subject to Federal estate taxes. The ⅔rds share of the decedent's separate property and the decedent's ½ share of all community property (other than the family automobile) passed from decedent to the Trustees for the benefit of the named children and no part thereof is claimed to be excludable under the marital deduction provisions for the simple reason that such property did not pass to the surviving spouse.

Under the Revenue Code of 1939, Section 105, it is provided that where a gift is made in property, the value thereof at the date of the gift shall be considered as the amount of the gift. Regulation 108, Sec. 86.19, in expounding upon such section, defines fair market value of the property on the date of the gift as the yardstick for measuring the amount of the gift. Such section of the Gift Tax Statute and Regulations thereunder with which the respondents have no quarrel are obviously applicable under the provisions of Section 812(e)(1)(E)(ii), in valuing the property that passed from the decedent to the surviving spouse in the present case.

No dispute exists as to the valuation of the ⅓rd interest in the separate property and the ½ interest in the family automobile as finally determined by the Commissioner on audit of the estate tax return, paragraph 10 of Stipulations filed in trial court (R. 39). It is only the ⅓rd interest in the community property and the ½ interest in the automobile that in any manner qualify for the marital deduction insofar as the present question is concerned; and since such property passed to the complete control of the surviving spouse upon her election, the value of same is entitled to be deducted under the marital deduction provisions in determining the estate tax liability of the decedent, which is the only matter presented for issue. By no stretch of the imagination can it be said that this property passed to anyone other than the surviving spouse or that it passed "through" the surviving spouse to any other person.

The gift tax consequences of the passage of Mrs. Stapf's 1/6th share of the community property from Mrs. Stapf to the Trustees for the benefit of her children is not in issue here and is not before the Court for consideration. The fact that under the Gift Tax Statute and cases construing such Statute, the surviving spouse may be entitled, in determining the value of her taxable gift to the trust, to subtract therefrom the value of the property passing to her under the decedent's will, would not be presented for determination by this Court if writ of certiorari were granted.

If this is a matter, which, in the opinion of petitioner, needs congressional action, relief should be sought there, and not here because of the limited issue here presented, and because of the clear and express provisions of the Statute here in issue. Such statutory provisions require the conclusions reached by both the trial court and the Court of Appeals that the property unquestionably passing to Mrs. Stapf qualifies for the marital deduction, and its value is not to be reduced to a negative value in decedent's estate for estate tax purposes merely because Mrs. Stapf's gift tax consequences might be lessened as a result of her election by which she received absolute title to certain of decedent's property, of an unquestioned value to her, equal to the value of such property in the hands of the decedent.

To disregard the clear requirements of the marital deduction statute, and to attribute to such statute an intent contrary to the express provisions, simply because there might be loss of taxation revenue under the gift statute, as the court below refused to do, and as the petitioner con-

tends should be done, is to emasculate, by the desire for greater taxes, the marital deduction provisions. This would levy an estate tax twice on property which Congress has said should be taxed only once. The petitioner's contentions, if sustained, but not the decision of the Court of Appeals, would destroy the clear intent of Congress in the enactment of the marital deduction statute.

## II. THE DEDUCTION FOR CLAIMS AGAINST THE ESTATE

Petitioner misconstrues or ignores the limits of the holding of the Court of Appeals below. The Court did not hold that every debt was deductible in its entirety, but its holding as to deductible claims is limited by the facts involved in this case to administration expenses and debts imposed by law. If the debts claimed as deductions were founded upon a promise or agreement, the deduction thereof as a claim against the estate would be limited, under the decision below, to ½ of such indebtedness where ½ of the consideration received under the debt, such as the proceeds of a loan, went into the estate of the surviving wife. The concern of petitioner over the possible loss of taxation revenue is exaggerated.

The decision below involving Texas law can only affect Texas estates and has a limited application. This is true since Sec. 812(b) of the 1939 Internal Revenue Code specifically provides that the law of the state under which the estate is being administered is determinative of what claims against the estate are to be allowed as deductions. *First-*

*Mechanics Nat. Bank of Trenton, et al. v. Commissioner of Internal Revenue, 3rd Cir., 117 Fed. 2d 127; Lang's Estate v. Commissioner of Internal Revenue, 9th Cir., 97 Fed. 2d 867; Thompson v. Wiseman, 10th Cir., 233 Fed. 2d 734; Blair v. Stewart, 5th Cir., 49 Fed. 2d 257.*

If the debt and expense assumption by the decedent is to be treated, not as a claim against the estate, but as a legacy or testamentary gift to the surviving spouse, then, as admitted by the petitioner on page 15 of the petition, such assumption or legacy would qualify as a marital deduction, to the extent that the amount thereof, together with other testamentary gifts to the wife qualifying for the marital deduction, do not exceed one-half of the "adjusted gross estate", thereby reducing the taxable estate just as effectively as if the debts assumed were deducted under Section 812(b) of the 1939 Code.

Likewise, if only one-half of the community debts and administration expenses are deducted in the decedent's estate as claims against such estate, then in Texas the other one-half of administration expenses are allowable as income tax deductions to the surviving wife under Section 23(a)(2) of the Internal Revenue Code of 1939. See Revenue Ruling 55-524, Cumulative Bulletin 1955-2, page 535. As pointed out by Jackson in *Community Property and Taxation, 12 Southwestern Law Journal, page 37*:

> "From a tax point of view this treatment of administration expense works to the advantage of the family. The income tax deduction to the surviving spouse is

generally more beneficial than the estate tax deduction since income tax rates are usually higher than the estate tax rate."

The example on pages 14 and 15 of petition, as expanded by footnote 16 on page 15 of the petition, by which an estate of $1,000,000.00 gross community property and $500,000.00 community debts could escape taxation for estate tax purposes by the assumption of the indebtedness by the husband in his will and the comparison of a like situation to a non community property estate is not only not justified by the opinion of the Court of Appeals, but is contrary thereto. This is made clear in paragraph "Third" of the opinion, App. 13a. The Court there points out that the debts that may be deducted in determining the taxable estate are only the debts imposed by law. It is there further specifically held that the contention of the Government that only ½ of the debts founded upon a promise or agreement would be deductible in the decedent's estate under a provision of the kind here involved was correct. The Court stated in this connection, App. 13a:

> "The contention of the government would be well taken if the debts were founded on contract; otherwise a deduction could be claimed against the estate of decedent for a debt where one-half of the consideration received under the debt, such as the proceeds of a loan, went into the estate of the surviving wife. Here, however, no effort has been made to segregate the debts as between being founded on contract or imposed by law and none are pointed out as arising under contract."

Thus, in Texas and other community property states, contrary to petitioner's present assertion, the taxable estate

of the decedent could not be reduced to zero by borrowing money or incurring debts for the community estate equal to ½ of the total gross estate, under the express holding of the Court of Appeals. Any funds so borrowed would equally benefit the wife's ½ of the community estate and the husband's ½ of the community estate, and would not be deductible in the full amount of the indebtedness since such indebtedness would be founded upon a promise or agreement, and, under Section 81.36 of Regulations 105 (1939 Code), would be limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. Thus, under the holding of the Court of Appeals, the deduction in the exampled estate would be limited to ½ of the borrowed funds and the net taxable estate would be $250,000.00 in both the common law and community property state, under hypothetical cases presented on pages 14 and 15 of the petition.

When the various contingent situations are considered in their proper perspective and the opinion of the Court of Appeals is properly construed, it is obvious that no breath-taking loss of taxation revenue will result from the application of the decision below.

The concern that uniformity in the application of the Statute with respect to deductions as between common law and community property states cannot be made the basis of a decision herein because under the very provisions of Section 812(b) of the Revenue Code of 1939, the allowance of such deduction vel non and the quantum of the deduction

is determined by the laws of the state in which the estate is being administered.

Actually uniformity is not achieved even in the same state. This is made clear by Judge Wisdom in his dissenting opinion, where he points out, App. 33a, that in Texas, should the husband die first, ½ of the costs of administration are charged against his estate, *Katherine Schuhmacher, 8 T.C. 453 (1947)*. But should the wife die first, all of the expenses of administration are deductible, *Blackburn's Estate v. Commissioner, 5 Cir., 1950, 180 F. 2d 952*. Lack of uniformity could not be more evident.

Uniformity in the application of the statute with respect to deductions was not expected by Congress as was pointed out by the U. S. Court of Appeals for the Third Circuit in *Commissioner v. Cardeza's Estate, 173 Fed. 2d 19.*

In practice, uniformity in treatment of deductions by the estate is certainly not achieved. Perhaps the lack of uniformity can best be illustrated by a reference to a few of the community property states. Thus, funeral expenses are deducted in their entirety from the ½ community property interest of the decedent if the estate is administered in Texas *(Blair v. Stewart, 49 Fed. 2d 257, 5th Cir., cert. denied, 284 U. S. 658)*, or in Idaho *(Estate of W. S. Lee v. Commissioner, 11 T.C. 141)*, while only ½ of the funeral expenses are deducted if the estate is administered in the State of Washington *(Lang's Estate v. Commissioner, 97 Fed. 2d 867; The Pacific National Bank of Seattle, 40 BTA 128)*.

In the absence of will provisions otherwise directing, only ½ of the administration expenses are deducted in Texas upon the theory that the whole of the community estate is being administered. *Estate of H. C. Schuhmacher, 8 T.C. 453.* The same is true in the State of Idaho, *Estate of W. S. Lee, 11 T.C. 141,* but the contrary is held in the State of Louisiana, *Vaccaro v. United States, 55 Fed. Supp. 932; McCullough v. United States, 134 Fed. Supp. 673; Estate of Thomas N. Gannett, 24 T.C. 654; Estate of William G. Helis, 26 T.C. 143.*

The principle asserted by these respondents and upheld by the court below was clearly recognized and set forth by the Board of Tax Appeals of the United States in *Estate of Lucy O. McGugan, Deceased, 47 BTA 658,* in which the Commissioner of Internal Revenue acquiesced. The headnote or syllabi appearing in the official Board of Tax Appeals report clearly states in shortened form the holding of the Court as follows:

> "Funeral expenses and expenses of last illness of a married woman dying testate a resident of Florida, paid pursuant to the terms of the last will and allowed by the laws of the state as a charge against the gross estate, HELD, a legal deduction from the gross estate."

The facts in the case were that the will of Mrs. McGugan provided:

> "I direct that all of my just debts and funeral expenses be paid out of my estate as soon after my decease as shall be found convenient."

The decedent was survived by her husband, Arthur McGugan. Under the laws of the State of Florida the surviv-

ing husband was primarily liable for the payment of the funeral expenses. The Court, however, gave effect to the provisions of the will and required that the funeral expenses be paid out of the estate of the decedent pursuant to the terms of the will and deducted from the gross estate in determining the net taxable estate. The Court in such regard said:

> "• • • It has been held that, even though under the common law these expenditures are regarded as primary liabilities of the surviving husband, the husband is relieved of such liability where the wife directs in her will that they be paid out of her estate and leaves sufficient property for their payment.
>
> "It is clearly the purpose of the Federal estate tax law to permit the deduction of such items if allowed by the laws of the jurisdiction under which the estate is being administered. Since it is stipulated that the items in dispute were paid by the executor and that the administration of the estate has been closed, the items apparently were allowed as deductions from the gross estate by the laws of the State of Florida.
>
> "We are of the opinion that the respondent erred in his disallowance of the deduction from the gross estate of the funeral expenses and expenses of decedent's last illness."

*Estate of Lucy O. McGugan, Deceased*, supra, was followed by the Tax Court in *Estate of Mrs. Sarah H. Bradley, Docket No. 106452, Prentice-Hall 1948 T.C. Memorandum Decisions, 1195; CCH 2 TCM 609*. There the Tax Court had under consideration whether the funeral expenses of the decedent wife should be allowed as a deduction in computing estate taxes where, under the laws of Georgia,

where the estate was being administered, the surviving husband is primarily liable for such funeral expenses. The will in such case provided that all just debts should be paid and a marble slab erected over the grave of the decedent.

The principle that community debts are deductible in their entirety from the decedent's ½ community interest for determining estate tax liability where directed by the provisions of the decedent's will was recognized by the 9th Circuit Court of Appeals in *Lang's Estate v. Commissioner, 97 Fed. 2d 867,* where it is stated at page 871:

> "On this issue we think the Board was correct in permitting a deduction of only one-half of these community obligations. Regardless of the incidents of the husband's personal liability for community debts during his lifetime, section 1342, Remington's Revised Statutes, supra, as construed by the Supreme Court of Washington, requires that community debts be satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition. *It is only by provision of a deceased husband's will that a community debt may be charged solely against his share of the community.* Redelsheimer v. Zepin, 105 Wash. 199, 202, 177 P. 736; In re Hart's Estate, 150 Wash. 482, 492, 273 P. 735." (Italics supplied.)

The right of a testator to charge community debts and administration expenses against his ½ part or share of the community estate where same would not otherwise be chargeable in its entirety, is recognized: in the State of Washington, *Lang's Estate v. Commissioner of Internal Revenue,* supra; *Redelsheimer v. Zepin, 105 Wash. 199, 177 Pac. 736; In re: Hart's Estate, 150 Wash. 482, 273 P. 735;* and in the

State of California, where it was stated *In re: Marinos' Estate, 102 P. 2d 443:*

> "The law is clear that in the absence of an expression of a contrary intent, the entire community property, including the interest of the surviving widow, is subject to the debts and expenses of administration upon the death of the husband. * * * The converse is also true—that is, if the will designates that debts should be paid from the interest of the husband, the wife's share of the community property is exonerated, if the husband's share is sufficient to pay all such debts and expenses. * * *"

The rule so clearly stated in the case last cited is the rule in Texas. Debts and administration expenses, though chargeable against the entire community estate in the absence of specific provisions to the contrary, are chargeable in their entirety against the deceased husband's one-half where the will so directs. This rule of law is made clear by the Court of Civil Appeals for the Seventh Supreme Judicial District at Amarillo in the case of *Medlin v. Medlin, 203 S.W. 2d 635,* and by the Supreme Court of Texas when a writ of error was refused in such case.

Other Texas cases recognize the right of a testator to direct that debts and expenses be paid out of certain portions of his estate, and that the determination of whether debts, expenses or administration and attorneys' fees should be borne by the community estate depends upon the intent of testator as expressed in his will. We refer to *Thompson v. Thompson, 236 S. W. 2d 779, 149 Tex. 632,* and *Matthews v. Jones 245 S.W. 2d 974, writ refused.* In the case last cited the decedent had written a will and various codicils. The suit involved the

question of who should be charged with the debts and expenses under the will and codicils. It is stated at page 977:

> "Judgment was entered in the District Court exonerating one-half of the separate property left in trust for the widow from payment of expenses of last illness and funeral, indebtedness of decedent for benefit of separate property, one-half of community indebtedness, expenses of administration of entire separate property and one-half of the community estate, the federal estate tax, all inheritance taxes, and charging the one-half of the community estate and one-half of the separate property left in trust for the children with the payment thereof.
>
> "* * *
>
> "It is urged by appellants that the will of Percy Jones 'made no provision, ambiguous or otherwise, as to apportionment of the burden of debts, expenses of administration or taxes among the beneficiaries' and that 'the court should have placed the burden, as a matter of law, and not of construction;' that, as a matter of law, the property devised in trust for the widow should be charged with a pro rata share of such items. The determination of the question here presented hinges upon the intention of the testator as expressed in the will, as evidenced by its terms when considered as a whole if his intent can be determined therefrom."

There can be no question with respect to the intent of the testator, Lowell H. Stapf, to charge all, and not merely ½, of the debts to his ½ share and part of the community estate until its exhaustion, and next to the separate estate. It is equally clear that the same was true with respect to administration expenses, including attorneys' fees incurred in connection with the administration of the estate.

Under the cases above cited, it cannot be questioned that the testator, Lowell H. Stapf, was fully authorized and em-

powered to charge his share and portion of the community estate with all of the community debts and all of the costs of administration and to exonerate the ½ share of Mrs. Stapf in the community property from such debts and expenses. It cannot be questioned that Mr. Stapf did in his will everything possible to charge his ½ of the community estate with such debts and taxes. Since Mr. Stapf was permitted by the laws of the State of Texas to do just what he did by his will, then such debts and expenses are deductible in their entirety in determining the amount of net estate taxable for estate tax purposes because the state law determines what debts and expenses are to be deducted from the share and part of the estate being taxed, subject, however, to the limitation stated by the Court of Appeals that only ½ of the debts founded on a promise or agreement are deductible.

All arguments that only ½ of the debts are personal obligations of the decedent and therefore deductible only to such extent under the applicable regulations are ill founded and were properly answered by the Court of Appeals. As there pointed out this is, of course, a question of state law.

In Texas, the person to whom the various community debts are owed would be entitled to obtain a judgment against the decedent's estate for the full amount of such community debts. In fact, the general rule is that a personal judgment for community debts incurred by a husband can be obtained against the husband himself, or against his estate if he be deceased, and that, although the wife's interest in the community property is liable for the payment of community debts incurred by the husband, no personal judgment can be ob-

tained against her therefor. *Davis v. McCartney, 64 Tex. 584; Leatherwood v. Arnold, 1 S. W. 173, 66 Tex. 144; Anderson v. Bundick, 245 S. W. 2d 318, Tex. Civ. App., error refused n.r.e.; Rex Supply Co. v. Shepherd, 293 S. W. 342, Tex. Civ. App., error refused; Adams v. Bartell, 102 S. W. 779, Tex. Civ. App., error refused.*

Consequently, if the husband is the only one personally obligated on community debts, and if it can be said that only ½ of the community debts is a personal obligation, then the other ½ of his community debt would be the personal obligation of no one. It is submitted that it is improper to say, therefore, that the assumption of debts and expenses by the husband, as was done in this case, disqualifies ½ of such debts and a prorata part of the expenses because they do not meet the test of "personal obligations" of the decedent. Unquestionably, the community half of the surviving spouse is only secondarily liable for these indebtednesses, particularly under the provisions of the will. If a decedent, whose estate is only secondarily liable for debts and expenses, can assume such liabilities by the terms of her will, thereby rendering such debts deductible in her estate for estate tax purposes, as was the case in *Estate of Lucy O. McGugan, Deceased*, supra, and *Estate of Mrs. Sarah H. Bradley*, supra, then surely the debts and expenses assumed by a testator who was primarily and personally liable for such debts are deductible in their entirety in determining estate tax liability.

The Court of Appeals recognized and gave effect to the Texas decisions and properly analyzed and applied the local law of the State of Texas to this case, and determined the

decedent could obligate his estate by his will to pay the debts and expenses as he did. Such being true, then under the clear provisions of the Statute and Regulations the expenses and debts, to the extent they were allowed by the Court of Appeals, were clearly deductible as claims against the estate as was determined by the Court of Appeals.

## CONCLUSION

As was pointed out by this Court in *The Hanover Bank, Executor, v. Commissioner of Internal Revenue, 369 U.S. 672, 8 L. Ed. 2d 187*, decided May 21, 1962:

> "A firmly established principle of statutory interpretation is that 'the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses.' Crane v. Commissioner, 331 US 1, 6, 91 L ed 1301, 1306, 67 S Ct 1047."

Applying such principles, the Court of Appeals concluded that the Statutes here involved were clear and required the decision entered herein. Petitioner cites no decision conflicting therewith.

Where the statutory language is clear, as it was here found to be by the Court of Appeals, then the proper rule to be applied was stated in *Hanover Bank v. Commissioner*, supra, as follows:

> "Under such circumstances we are not at liberty, notwithstanding the apparent tax-saving windfall bestowed upon taxpayers, to add to or alter the words employed to effect a purpose which does not appear on the face of the statute."

The petitioner here vigorously contends that because of the feared loss of taxation revenue a writ of certiorari should be

granted herein, and Sections 812(b) and 812(e) of the Revenue Code should be rewritten to avoid the feared loss of revenue which the petitioner asserts could possibly occur. Such argument is best answered by the concluding statement and footnote reference in *Hanover Bank v. Commissioner*, supra, as follows:

> "Nevertheless, the Government now urges this Court to do what the legislative branch of the Government failed or elected not to do. This, of course, is not within our province.[23]

"[23]We believe the Court of Appeals for the First Circuit was correct when it said in Fabreeka Products Co. v. Commissioner, 294 F2d 876, 879: 'Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the Congressional thumb, not the court's.' See also Evans v Dudley (Pa) 295 F2d 713, 715, where the Third Circuit quotes this language from Judge Aldrich's opinion in Fabreeka Products."

For the reasons stated, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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## APPENDIX A

### INTERNAL REVENUE CODE OF 1939 (AS AMENDED, 26 U.S.C., 1952 ED.)

SEC. 812. NET ESTATE.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

* * * * *

(b) [as amended by Secs. 405(a), 406, Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 502, Revenue Act of 1950, c. 994, 64 Stat. 906]. *Expenses, Losses, Indebtedness, and Taxes.*—Such amounts—

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages upon, or any indebtedness in respect to, property where the value of decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered, but not including any income taxes upon income received after the death of the decedent, or property taxes not accrued before his death, or any estate, succession, legacy, or inheritance taxes. The deduction herein allowed in the case of claims against the estate, unpaid

mortgages, or any indebtedness shall, when founded upon a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth; * * *. There shall be disallowed the amount by which the deductions specified in paragraphs (1), (2), (3), and (4) exceed the value, at the time of the decedent's death, of property subject to claims. For the purposes of this section the term "property subject to claims" means properly includible in the gross estate of the decedent which, or the avails of which, would, under the applicable law, bear the burden of the payment of such deductions in the final adjustment and settlement of the estate; and, for the purposes of this definition, the value of the property shall be reduced by the amount of the deduction under the next sentence attributable to such property. * * *

For the purposes of this subchapter, a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration "in money or money's worth."

* * * * * *

(e) [As added by Sec. 361(a), Revenue Act of 1948, c. 168, 62 Stat. 110] *Bequests, Etc., to Surviving Spouse.*—

(1) *Allowance of marital deduction.*—

(A) *In General.*—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to

the extent that such interest is included in determining the value of the gross estate.

* * * * *

(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—

* * * * *

(ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

* * * * *

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## TREASURY REGULATIONS 105 (1939 CODE)

SEC. 81.36. *Claims against the estate.*—The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, whether or not then matured, and interest thereon which had accrued at the time of death. * * * Only claims enforceable against the decedent's estate may be deducted. Except as hereinafter stated, if the claim is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. * * *

SEC. 81.47a [as added by T. D. 5699, 1949—1 Cum. Bull. 181, 195]. *Bequests, etc., to surviving spouse.*—(a) *Allow-*

*ance of marital deduction.* In the case of the estate of a citizen or resident of the United States dying after December 31, 1947, there may be deducted the value of any property interest (except as otherwise provided in section 81.47b and 81.47d) which passed from the decedent to his surviving spouse. Such deduction is hereinafter referred to as the "marital deduction." The marital deduction is generally not available in case the decedent's gross estate consists exclusively of property held by him and his surviving spouse as community property under the law of any State, Territory, or possession of the United States, or any foreign country. (See section 81.47d.) * * *

* * * * * *

SEC. 81.47c [as added by T. D. 5699, 1949—1 Cum. Bull. 181, 206]. *Valuation of property interest passing to surviving spouse—*

* * * * * *

(b) *Property interest subject to an incumbrance or obligation.* Section 812(e)(1)(E) provides that where a property interest passed from the decedent to his surviving spouse subject to a mortgage or other incumbrance, or where an obligation is imposed upon the surviving spouse by the decedent in connection with the passing of a property interest, the value of such property interest is to be reduced by the amount of such mortgage, other incumbrance, or obligation. The passing of a property interest subject to the imposition of an obligation by the decedent does not include a bequest, device, or transfer in lieu of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or

of other marital rights in the decedent's property or estate. The passing of a property interest subject to the imposition of an obligation by the decedent does, however, include a bequest, etc., in lieu of the interest of his surviving spouse under community property laws unless such interest was, immediately prior to the decedent's death, a mere expectancy. * * *

The following are illustrative of property interests which passed from the decedent to his surviving spouse subject to the imposition of an obligation by the decedent:

(1) A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000.

* * * * * *

(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife.

* * * * * *

## APPENDIX B

### In the United States Court of Appeals for the Fifth Circuit

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No. 18974

UNITED STATES OF AMERICA, APPELLANT-APPELLEE,

*versus*

DOROTHY ANNE STAPF AND B. T. WARE, II, EXECUTORS AND TRUSTEES OF THE ESTATE OF LOWELL H. STAPF, DECEASED, AND DOROTHY ANNE STAPF, INDIVIDUALLY, APPELLEES-APPELLANTS (AND REVERSE TITLE)

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*Appeal from the United States District Court for the Northern District of Texas*

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(September 26, 1962)

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Before BROWN, WISDOM, and BELL, *Circuit Judges.*

BELL, *Circuit Judge:* This is an estate tax case. The opinion of the District Court is reported at 189 F. Supp. 830. Suit was filed by the executors of the estate of Lowell H. Stapf for a refund of estate taxes and interest paid pursuant to a deficiency asserted against the estate.

All facts have been stipulated. Mr. Stapf died testate on July 29, 1953, a Texas resident and domiciliary. His will was probated in Texas where his principal estate consisting of separate and community property, was situated. His will put his wife to an election[1] either to elect not to take under

[1]The doctrine of election under the Texas law is well established. See *Dakan* v. *Dakan*, 1935, 125 Tex. 305, 83 S.W. 2d 620; *Smith* v. *Butler*, 1892, 85 Tex. 126, 19 S.W. 1033; and 44 Tex. Jur., Wills, § 285 et seq.

the will and thereby retain her one-half interest in the community estate, or to allow her one-half interest to be disposed of under his will in order that she might receive specified benefits thereunder.

The benefits included one-third of the residue, consisting of the whole of the community property and separate property of a value of $65,100 owned by the decedent, less specific bequests. The benefits also included an automobile, itself community property in which the widow owned a one-half interest. The will provided that if she should elect to take under its provisions, all funeral expenses, costs of administration and claims against the estate, whether community or separate, should be paid out of the one-half interest of decedent in the community property. Community debts totalled $32,367.74, while expenses of administration, including attorneys' fees, were $4,073.47 and the community of the husband was sufficient to pay these.

Electing not to take under the will, the widow would have retained her one-half of the community property, subject to its pro-rata share of expenses of administration and one-half of the community debts, having a net value of $111,442.68. Taking, she became entitled to one-third of the gross value of decedent's separate estate ($21,666.66), the one-half interest of the husband, value at $700 in the community automobile, and one-third of the combined community estate. This had a value of $106,268.18, or $5,174.50 less than the value of the interest Mrs. Stapf would have retained had she not elected to take under the will. Computed differently but with the same result, the widow

retained a one-third interest out of the one-half of the community owned by her, thereby transferring only a one-sixth interest under the election to take. Under this method of computation she transferred property having a valuation of $27,541.16 and received property being the one-third interest in the separate property of the husband and the one-half interest in the automobile of the aggregate value of the $22,366.66, making a net loss to her of $5,174.50. The government uses one method while the taxpayer uses the other. Either is sufficient for our purposes.

The taxpayer, having been notified of a deficiency after filing the estate tax return, paid the deficiency and claimed a refund. It being denied, suit was filed and this appeal is from the judgment of the District Court. The taxpayer appeals from the disallowance of the community debts and administration expenses as deductions from the gross estate of decedent under § 812(b) of the Internal Revenue Code of 1939, 26 USCA, § 812(b). The government appeals from the allowance of an exclusion from the gross estate as a part of the marital deduction of the one-third of the separate property of decedent and the one-half interest in the community automobile passing to the widow under her election to take under the will, contending that this devise was incumbered or obligated within the meaning of §812(e)(1)(E)(ii) of the Internal Revenue Code of 1939, 26 USCA, §812(e)(1)(E)(ii), in an amount exceeding the value of the devise received by the widow in that the property transferred by her was of a greater value than that received by her.

As to the deductibility of the total of the debts and expenses from the community of decedent alone,[2] §812 of the Internal Revenue Code of 1939, as amended, being the applicable statute, provides in part:

> "§ 812 NET ESTATE
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> "For the purpose of the tax the value of the net estate shall be determined, * * * by deducting from the value of the gross estate—
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> "(b) * * * such amounts—
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> "(1) for funeral expenses[3]
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> "(2) for administration expenses,
>
> "(3) for claims against the estate,
>
> "as are allowed by the laws of the jurisdiction, whether within, or without the United States, under which the estate is being administered, * * *. The deduction herein allowed in the case of claims against the estate * * * shall, when founded upon a promise or agreement, be limited to the extent that they are contracted bona fide and for an adequate and full consideration in money or money's worth * * *.

This section is the same as §303 of the Revenue Act of 1926 with respect to which it was said in *First-Mechanics Nat. Bank of Trenton v. Commissioner of Internal Revenue*, 3 Cir., 1940, 117 F. 2d 127:

> "Unquestionably a claim against a decedent's estate which is allowed by the laws of the jurisdiction under

[2]The debts of decedent totalled $32,367.74, all of which were community debts, including $23,701.34 due for 1951 income taxes, and interest thereon in the amount of $1,955.33. The expenses of administration totalled $4,073.47. The Commissioner determined that 65 percent of the expenses of administration should be allocated to and deducted from the gross estate of decedent, and the remaining 35 percent allocated to the widow's one-half of the community estate. This allocation was affirmed by the District Court and the allocation is conceded to be correct if the expenses are not deductible. Ad valorem taxes due amounted to $1,954.96.

[3]Allowed *in toto* here. *Blair* v. *Stewart*, 5 Cir. 1931, 49 F. 2d 257.

which the estate is administered is deductible in determining the net estate subject to federal tax. The Revenue Act applicable to the instant case specifically so provides."

Cf. *Blair v. Stewart*, Footnote (3), supra; and *Lang's Estate v. Commissioner of Internal Revenue*, 9 Cir., 1938, 97 F. 2d 867, on appeal from the Board of Tax Appeals, 34 B.T.A. 337. Thus, uniformity in the application of the statute was not expected by the Congress, and we look to the law of Texas to determine this issue.

The principle that community debts are deductible in their entirety from the community interest of the decedent in determining estate tax liability where directed by the provisions of the will was recognized, although not applied, in *Lang's Estate v. Commissioner*, supra:

> "On this issue we think the Board was correct in permitting a deduction of only one-half of these community obligations. Regardless of the incidents of the husband's personal liability for community debts during his lifetime, Section 1342, Remington's Revised Statutes, supra, as construed by the Supreme Court of Washington, requires that community debts be satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition. It is only by provision of a deceased husband's will that a community debt may be charged solely against his share of the community. Redelsheimer v. Zepin, 105 Wash. 199, 202 177 P. 736; In re Hart's Estate, 150 Wash. 482, 492, 273 P. 735."

There was no provision in the will in that case to charge the whole of the claims against the community of the decedent, but the holding was that the claims in any event were

not personal obligations of the decedent within the meaning of the Washington law as required by the regulation.

The Applicable Treasury Regulation, 105 (1939 Code), provides in pertinent part:

> "SEC. 81.29 *Deduction of administration expenses, claims, etc.*—In order to be deductible * * * the item must fall within one of the several classes of deduction * * * enumerated * * * and must also * * * be one of payment of which out of the estate is authorized by the laws of the jurisdiction under which the estate is being administered. Unless both of these conditions exist the item is not deductible. * * * If a claim against the estate, an unpaid mortgage, or an indebtedness is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth, * * *."
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> "SEC. 81.32 *Administration Expenses.*—* * * Administration expenses include (1) executor's commissions; (2) attorney's fees; (3) miscellaneous expenses. * * *"
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> "SEC. 81.36 *Claims against the estate.* — The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, * * *. Only claims enforceable against the decedent's estate may be deducted. If the claim is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. * * *"

Measured by the criteria of the statute and the regulation, which adds the additional requirement that the claims be personal obligations, we hold that the debts and expenses

here were deductible in full from the community interest of decedent, and reverse to that extent.

First, the Texas case law makes it abundantly clear that decedent by the terms of his will could so obligate his estate and his community property. *Medlin v. Medlin*, Tex. Civ. App., 1947, 203 S. W. 635; and *Matthews v. Jones*, Tex. Civ. App., 1952, 245 S. W. 2d 974. It is true that neither of these cases involved taxes, but the regulation here requires only that the payment be authorized under the Texas law. Cf. *In re Marino's Estate*, Cal. Dist. Ct. App., 1940, 102 P. 2d 443.

Second, the government contends that only one-half of the debts represented personal obligations of the decedent and for that reason only one-half may be claimed as deductible. Cf. *Lang's Estate*, supra. This, too, is a question of state law. The general rule is that on dissolution of the community the husband, but not the wife is personally liable for community debts. 31 C.J.S., Husband and Wife, §566b(1), p. 100. This is the law of Texas. A judgment could have been obtained against the estate of decedent for the full amount of the community debts. Of course, the community of the wife under Texas law is liable for payment of the community debts, and her husband could recover from it for advances made to pay community debts, but no personal judgment could be obtained against her for community debts. The surviving wife does not personally owe the community debts. *Leatherwood v. Arnold*, 1886, 66 Tex. 414, 1 S. W. 173; *Security Nat. Bank of Wichita Falls v. Allen*, Tex. Civ. App., 1924, 261 S. W. 1057; *Sargeant v.*

*Sargeant*, Comm. of App., 1929, 118 Tex. 343, 15 S. W. 2d 581; and *Anderson v. Bundick*, Tex. Civ. App., 1952, 245 S. W. 2d 318. The debts were personal to decedent and to him only under the Texas law. The fact that the community property or even his property was sufficient to pay the debts does not take them out of the personal category.

Third, it is contended that there was no full and adequate consideration for more than one-half of the debts. The statute itself was amended in 1932 to make it clear that this requirement applies only where the debt is founded upon a promise or agreement,[4] and thus we do not reach the question of consideration for the debts here were in the main for income taxes and ad valorem taxes, debts imposed by law. The contention of the government would be well taken if the debts were founded on contract; otherwise a deduction could be claimed against the estate of decedent for a debt where one-half of the consideration received under the debt, such as the proceeds of a loan, went into the estate of the surviving wife. Here, however, no effort has been made to segregate the debts as between being founded on contract or imposed by law and none are pointed out as arising under contract.

The direction in the will of decedent, and the Texas law, coupled with the provisions of the Revenue Statute and Regulation, make it clear that the total of the debts and expenses of administration as specified in the findings of fact by the District Court were deductible from the gross

[4]Senate Report No. 665, 72nd Congress, 1st Sess., p. 51 explains the amendment (§ 805 of the 1932 Act) as limiting the requirement for consideration to liabilities founded on contract, as distinguished from liabilities imposed by law or arising out of torts.

estate of decedent. The District Court erred in not so holding. Cf. *Estate of Lucy O. McGugan v. Commissioner of Internal Revenue*, 1942, 47 B.T.A. 658, where the expenses of last illness and funeral expenses were allowed as a deduction from the gross estate of the wife, although these expenses were the primary liability of the husband under Florida law, where the wife provided by her will for payment out of her estate. See also *Estate v. Sarah H. Bradley v. Commissioner*, Memorandum opinion, Docket No. 106452, 1943, CCH, 2 TCM 609 involving a Georgia estate to the same effect.

We affirm that part of the judgment holding that the devise to the widow of one-third of the separate property of decedent and the one-half interest in the community automobile qualified as a part of the marital deduction or exclusion from the estate of decedent.[5]

Certain basic facts must be borne in mind in considering this question. There was no exchange of property between the testator and Mrs. Stapf, and she did give to the testamentary trust set up by decedent more than she received under the will. Only decedent's one-half interest in the community property is includible in his gross estate for federal tax purposes, *Commissioner of Internal Revenue v. Chase Manhattan Bank*, 5 Cir., 1938, 259 F. 2d 231, and

[5]The Commissioner allowed the one-half community interest of the husband in the automobile as a part of the marital deduction. No issue was raised to such allowance by the government in the trial court where the allowance was affirmed. Now it is asserted that the Commissioner was in error in the allowance which was based on his belief that Mrs. Stapf would have received the automobile whether she elected to take under the will or not. While this belief of the Commissioner was incorrect because the devise of the automobile was also based on the election, under our decision we do not reach this question.

there is no contention that the property of the widow passing by the election under the will of decedent became a part of his gross estate for estate tax purposes. And, lastly, under the Texas law the devise of one-third of the whole community to the widow did not pass to her under the will but was satisfied out of her own one-half. *Jones v. State*, Tex. Comm. App., 1928, 5 S. W. 2d 973; and *Calvert, Comptroller v. Fort Worth National Bank*, Tex. Sup. Ct., 1962, 356 S. W. 2d 919.

The statute here in question, par. (e)(ii) of §812(e)(1), supra, having to do with the valuation of marital deduction property passing from a decedent to his surviving spouse is as follows:

> "(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—
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> "(ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

The government relies on Treasury Regulation 105 (1939 Code), §81.47c(b), which extends the language of this statute to include an election as here, specifying by example that in computing the marital deduction the value of the bequest to a widow is to be reduced by the value of the community property interest relinquished by her. Neither this section of the Act or its legislative history envision

such an example or result.[6] The regulation in this regard changes the plain terms of the statute by sweeping away the last clause thereof and must give way to the statute. *Kosland v. Helvering, 1936*, 298 U. S. 441, 56 S. Ct. 767, 80 L. Ed. 1268; *Miller v. Commissioner of Internal Revenue*, 5 Cir., 1956, 237 F. 2d 830.

We also put aside the contention of the taxpayer that an encumbrance or obligation to be taken into account in valuing the property to be excluded means an encumbrance or obligation on the property such as a lien against the property for a debt, as distinguished from an obligation or encumbrance in the nature of a condition as here under the election. *Wachovia Bank & Trust Co. v. United States*, Ct. Cl. 1958, 163 F. Supp. 832.

We look to the terms of the statute itself for its meaning. The last clause of it teaches how the valuation is to be computed and this is the key to the determination of this issue. It shall be taken into account in the same manner as if the amount of a gift of such interest by the husband to his wife was being determined.

The value of a gift by a husband to a wife of property, on the condition that she surrender to, or give for the benefit of a third party a portion of her property, would not be reduced or "netted" by the amount of property given up by the wife. There must be a monetary consideration or like benefit to the original donor before the value of the property surrender is to be deducted from the value of the gift. *Commissioner of*

[6]Senate Supp. Report No. 1013, Part 2, 80th Cong., 2nd Sess.; House Report No. 1274, 80th Cong., 2nd Sess.

*Internal Revenue v. Wymyss*, 1945, 324 U.S. 303, 65 S. Ct. 652, 89 L. Ed. 958; *Commissioner v. Bristol*, 1 Cir., 1941, 121 F. 2d 129; and *Estate of Koert Bartman*, 1948, 10 T.C. 1073. All that Mrs. Stapf did by her election was to take the property devised to her and in turn surrender part of her property to the trust for the benefit of her children. Within gift tax confines the community property of the widow passing under the will of the husband to others may not be "netted" against the devise to the widow, and thus testator, were the transfer inter vivos, would be liable for gift taxes on the full value of the devise.[1] Viewed in this light the devise of the one-half interest in the automobile and the one-third interest in the separate property of the testator qualify as a part of the marital deduction and the District Court did not err in so holding.

The gift and estate tax statutes complement each other. Here estate taxes are due now on the property of the husband with the devise to the widow excluded. It is a part of the marital deduction or exclusion on which taxes are deferred to the estate of the widow to be assessed on so much of it as survives on another day. The net of the transfer by the widow became subject to gift taxes at the time of the transfer. The property transferred by the widow will, to the extent of an amount equal to the devise to her, escape both gift and estate taxes. Nevertheless, and this applies alike to our holding on the deductibility of the debts and expenses of adminis-

[1] *Aliter* on the transfer by the widow. The devise would be "netted" against what she surrendered as she did receive consideration of the necessary type: *Commissioner v. Seigel*, 9 Cir., 1957, 250 F. 2d 339; *Commissioner v. Chase Manhattan Bank*, supra; and *Turman v. Commissioner of Internal Revenue*, supra.

tration here, it is something permitted by the statute and proscription, if indicated, is for the Congress.[8]

Having reversed in part and affirmed in part we REMAND for such other and further proceedings as may be necessary and which are not inconsistent herewith.

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WISDOM, *Circuit Judge*, dissenting:

I respectfully dissent.

With deference, I feel compelled to say that, in my opinion, the result reached by the majority is repugnant to fundamental principles of community property law. Nothing in Texas law requires the holding. Nothing in tax law requires it. And, the decision is inconsistent with the purposes of the equalization provisions of the Revenue Act of 1948 which put an end to the tax War-Between-the-States.

## I.

## Testamentary Instructions to Pay Community Debts and Administration Expenses.

### A. The Will

This case stands alone. As far as I have been able to discover, no one, in Texas or in any other traditional community property state, ever before dreamt up the notion that

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[8]On the subject of a windfall under another tax statute, it has been aptly said:

"Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the congressional thumb, not the court's." *Fabreeka Products Co. v. Commissioner*, 1 Cir., 294 F. 2d 876,879, cited in *The Hanover Bank, Extr. v. Commissioner*, No. 224, Supreme Court, October Term, 1961, decided May 21, 1962, 40 L.W. 4385, — U.S. —, — S. Ct. —, —, — L. Ed. 2d —.

by instructing his executors to pay the community debts from his share of the community a testator could:

> (1) double the federal estate tax deduction for his half of the debts of the community and
>
> (2) correspondingly increase his widow's share of the community which, as her share by vested right, is not includible in his taxable estate.

This notion is so contrary to one's ingrained understanding of the community as a partnership, I question whether Stapf's will did indeed intend the executors to take the extreme position they have taken. The will does not, in terms, require it.

The will does make plain the testator's intention that the debts and charges against the community should be payable from his share of the community or from his separate property. This is a testamentary provision common in a community property state. "There is no doubt", as Judge Dooley, the district judge below, remarked, "that a testator may lawfully exercise selectivity among different portions or different devises and bequests of his estate and order an impact of liabilities resulting in disproportionate burdens, or even a total burden on the one hand and exoneration on the other, and that is true in respect of payment of taxes, even the Federal Estate Tax." 189 F. Supp. 830, 834. Usually, "the intention of testator [is] to give his wife her interest in the community estate free from all claims of debts so far as the other legatees [are] concerned." *Redelsheimer v. Zepin*, 1919, 105 Wash. 199, 177 p. 736. See also *In re Hart's*

*Estate*, 1929, 150 Wash. 482, 273 p. 735.[9] "This would allow of the division or partition of the community property between the surviving spouse and the heirs of the deceased spouse before debiting against such property the community property debts, so that the share going to the surviving spouse would go free of any liability for the community debt." 1 DeFuniak, Principles of Community Property Law, §211 (1943). The Texas cases cited in the majority opinion are to the same effect. *Medlin v. Medlin*, Tex. Civ. App., 1947, 203 S.W. 2d 635; *Mathews v. Jones*, Tex. Civ. App., 1952, 245 S.W. 2d 974. In such cases, the dispute is only over the construction of the will. There is no holding and no intimation in these decisions that the purpose or effect of a will such as Stapf's is to enable executors to take a tax deduction for paying the debts chargeable by law to the wife's share of the community.

A simple, reasonable construction of the will is that Stapf's purpose was to make the inducements so attractive Mrs. Stapf would feel duty bound to take under the will. Should she resist the will, her share of the expenses and debts would be payable from her half of the community. The legal effect of the pertinent testamentary language is to make a conditional gift or legacy to the widow in an amount equal to half of the charges against the community. The bequest is at the expense of the other distributees and effects a redistribution of the decedent's estate. But it is no different from instructions to the executors to pay the mortgage on a son's house, or to pay the debts of a third person. It is a straight pecuniary legacy.

[9] Both cases are cited in Lang's Estate v. Commissioner, 9 Cir., 1938, 97 F. 2d 867.

## B. Texas Law

The basic error of the majority lies in their not recognizing that in the settlement of the community, following its dissolution, the community is regarded as a third person, vis-a-vis husband and wife. It is not a civil person in the common law sense, but time and again courts have referred to it as a separate entity. "[T]he laws of Washington establish a community between spouses which is a separate entity, 'just as a corporation or an association'."[10] More often, the community is described as a partnership. In a very early case the California Court said:

> "Our whole system, by which the rights of property between the husband and wife are regulated and determined is borrowed from the civil law and Spanish law. . . . The relation of husband and wife is regarded by the civil law as a species of partnership, the property of which, like that of any other partnership is primarily liable for the payment of its debts." *Packard* v. *Arellanes*, 1861, 17 Cal. 531, 537.

In Texas the community is sometimes referred to as a "trust," but "there is nothing in such a 'theory' that conflicts with the view of a marital partnership, a term frequently used by the Texas Courts, since it is merely designed to make clear that fiduciary obligations are imposed upon the one holding the legal title, the same fiduciary obligations which are imposed on any partner who has control and management of partnership assets." 1 DeFuniak, Principles of Community Property § 95 (1943). In an authoritative

[10] Lang's Estate v. Commissioner, 1938, 304 U.S. 264, 58 S. Ct. 880, 77 L. Ed. 1066.

discussion of Texas community property law,[11] Judge Hannah described the community:

> "The relationship of the spouses in Texas during their life time is substantially that of partners in a commercial partnership, and the husband and wife are in all respects equal partners, the husband being the managing partner and vested with management powers."

As DeFuniak comments, "It is difficult to see how it can be observed in any other light, for it represents the right to share equally in acquets and gains of the spouses during the marriage as well as liability for the obligations incurred on behalf of the community, usual attributes of partnership." 1 DeFuniak, Principles of Community Property, § 95.

In keeping with the view that the community is regarded as a partnership separate from the partners, Texas law provides that the community property of husband and wife "shall be liable for their debts contracted during marriage." Art. 4620, Vernon's Ann. Tex. Civ. Stat. And, Section 156 of the Texas Probate Code, provides:

> "Community property, except such as is exempt from forced sale, shall be charged with all valid and enforcible debts existing at the time of the dissolution of marriage by death."

No individual has the testamentary power to change this law of Texas. In every case the community passes with the debts of the community charged against it. Tex. Prob. Code §§ 45, 1516.

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[11] Rompel v. United States, S.D. Tex., 1945, 59 F. Supp. 483, *rev'd* United States v. Rompel (Herbst), 1945, 326 U.S. 367, 66 S. Ct. 191, 90 L. Ed. 137. This is the Texas companion case to the Louisiana case of Wiener v. Fernandez, E.D. La., 1945, 60 F. Supp. 169; *rev'd* Fernandez v. Wiener, 1945, 326 U.S. 340, 66 S. Ct. 178, 90 L. Ed. 116 upholding the constitutionality of the Revenue Act of 1942.

Death dissolves the community. Then, as in the dissolution of a partnership, there is in equitable accounting between the separate estates of husband and wife and the community. See 30 Tex. Jur. 2d, Husband and Wife, § 134 and cases there cited. The personal liability of the husband provides no basis for shifting to him all of the community debts, even if he has paid the debts from his separate funds. "The rule is settled that the separate estate of one spouse must be reimbursed by the community estate for advances from such separate estate." *Snodgrass v. Robertson*, Tex. Civ. App., 167 S.W. 2d 534, err. ref. W.O.M. Even when a husband is sued and held liable on a community debt, the wife's share of the community is not relieved of liability. "It is well settled in [Texas] that even though the wife is not named as a party to an action by or against the husband concerning the community property, she is still bound by a judgment rendered against the husband in the action. This rule is based on the doctrine of virtual representation under which the husband is by law, designated the representative of the wife's interests in the community." 30 Tex. Jur. 2d., Husband and Wife, § 167.

The husband's personal liability, on which the majority relies as the principal basis for their decision, does not reduce the community's liability. It does not affect the liability of the widow's share for half the debts. It does not increase the amount (one-half) of the claims against the husband's estate when the community is sufficient to satisfy the claims. Thus:

> "Under our law the community property is the primary fund for the payment of community debts, and we think that where there exists sufficient community

> property to pay the community debts, no resort can be had to the separate property of the deceased husband for the purpose of paying such debts, though such property is, of course, liable if the community property should prove to be insufficient." *Clark v. First Nat. Bank*, Com. App. Tex., 1919, 210 S.W. 677, 679.

In short, the personal liability of a husband is that of a surety. If a husband pays community debts out of his separate estate, the community reimburses the separate estate on dissolution of the community. The wife is a special partner in a limited partnership since her liability is limited to her share of the partnership assets. The general partner's (the husband's) liability is unlimited because it is he who has the control and administration of the partnership. But the husband's unlimited liability for community debts and the wife's limited liability for such debts are no more determinative of their respective rights and liabilities as owners of the community, than are the corresponding liabilities of a general partner and the special partner in a commercial partnership in the common law in determining their respective property rights and liabilities. The fact that only the husband may be sued does not relieve the wife's share of any liability; it is really the community that is sued and must pay the claim to the extent of the community estate.

This brings us to the question of the effect of Stapf's will under Texas law. Texas law is clear beyond a doubt: if there had been no will, since the community was able to pay its debts only half of the debts would be allowed against Stapf's estate. Should the will make a difference? No. The wife's share was charged with half the debts before Stapf's death. His death dissolved the community, making it impossible for

Stapf to change the status of claims fixed prior to his death. The only change the will could make would be by providing a method for payment of debts. But a testamentary direction to executors to make a payment from the decedent's estate, to the benefit of another, is simply a legacy.

*If the reasoning of the majority were sound, logically Stapf's will should not affect the majority's conclusion. Their decision rests on the husband's personal liability for the community's obligations. But that liability exists without a will. It is completely independent of a will. Whether or not a husband is personally liable, when the community is dissolved Texas law divides the liabilities as it divides the assets.*

## C. Tax Law

1. *The "Claim" contemplated.* Section 812(b)(3), Internal Revenue Code of 1939, permits the deduction of such "claims against the estate as are allowed by the laws of the jurisdiction under which the estate is being administered." The state law does not apply of its own force. The federal tax law, for its own purposes, incorporates state law by reference. See Hart and Wechsler, The Federal Courts and the Federal System, p. 456; cf. *Towner v. Commissioner*, 182 F. 2d 903, 907 (2d Cir., 1950). The role played by state law in the taxing statute is explained by the Supreme Court in *Morgan v. Commissioner*, 309 U.S. 78, 80 (1940):

> "State law creates legal interests and rights. The federal revenue acts designate what interests or rights so created, shall be taxed. Our duty is to ascertain the meaning of the words used to specify the thing taxed. If it is found in a given case that an interest or right

created by local law was the object intended to be taxed, the federal law must prevail no matter what name is given to the interest or right by state law."

A similar principle should be applied in allowing or disallowing a claim under § 812(b)(3). The question to ask is whether a claim is the type of claim against the estate contemplated by the taxing statute.

The type of claim allowable as a deduction in determining the amount of a decedent's estate cannot be a claim based solely on the husband's personal liability for community debts. That is only a potential liability to creditors *which is washed out in this case* since the community property was sufficient to satisfy the debts of the community; claims against a solvent community after dissolution of the partnership are not against the decedent personally but are attributable to the marital estate. In the accounting between the separate estates of husband and wife and the community, the husband's liability would be for only half the claims. Regardless of the incidents of the husband's personal liability for community debts during his life time * * * community debts [are] satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition." *Lang's Estate v. Commissioner*, 9 Cir., 1938, 97 F. 2d 867. This puts the tax where it naturally falls, on half of the net community—the only part over which Lowell Stapf had testamentary control.

The salient feature of a true "claim" is its involuntary nature. The debtor owes the claimant money and the claimant

has a right to payment irrespective of the debtor's wishes. In this case the claim is provable against the testator's estate only because of the decedent's voluntary and gratuitous testamentary assumption of the claim. In *United States v. Mitchell*, 7 Cir., 1934, 74 F. 2d 571, the Seventh Circuit, in discussing whether an obligation, voidable under the Statute of Frauds, could be deducted if the executors had waived the defense and paid the claim, stated: "Nor can an asserted obligation which was enforceable only at the option of the deceased obligor be deducted."

2. *Authorities.* Neither *First-Mechanics Nat'l Bank v. Commissioner*, 3 Cir., 1940, 117 F. 2d 127, nor *Lang's Estate v. Commissioner*, 9 Cir., 1938, 97 F. 2d 867, relied on by the majority, supports the Court's holding. Each, especially *Lang's Estate*, points the other way. In *First-Mechanics* the court refused to allow as a deduction debts voluntarily paid by the state and approved by the state orphan's court. It concluded that since the estate was not obligated to pay the claim, the claim was not deductible. In *Lang's Estate*, as in this case, the taxpayers argued that under the law of the State of Washington, since "a husband is liable for community debts as fully as the community," the "entire amount of these community debts should be deducted from the gross estate." The court repudiated this contention:

> "Regardless of the incidents of the husband's personal liability for community debts during his lifetime, section 1342, Remington's Revised Statutes, supra, as construed by the Supreme Court of Washington, requires that community debts be satisfied pro rata from that portion of the community property distributable to the wife and

that portion subject to the husband's testamentary disposition. It is only by provision of a deceased husband's will that a community debt may be charged solely against his share of the community." *Redelsheimer v. Zepin*, 105 Wash. 199, 202, 177 P. 736; *In re Hart's Estate*, 150 Wash. 482, 492, 273 P. 735.

"If there be sufficient community property in the estate to discharge the obligations here in issue, then no more than one-half can be termed personal obligations of the decedent." *Lang's Estate v. Commissioner*, 9 Cir., 1938, 97 F. 2d 867, 871, 872.

In the next to last sentence of the quotation, on which the majority rely heavily, all that the court was saying was that Lang's will had not provided for payment of community debts out of his share; as a matter of *property law*, the claims were not provable against Lang's estate. The Ninth Circuit's citation of *Redelsheimer v. Zepin* and *In re Hart's Estate* makes this plain. Neither of these cases had anything to do with taxes; they turned on whether the testator intended burdening his share of the community with payment of all of the debts. Thus, *Redelsheimer v. Zepin*, holds that the testator intended "to give his wife her interest in the community estate free from all claims of debts *so far as the other legatees are concerned*." In *Hart's Estate* the court held that the testator intended "all debts should be paid first from the decedent's property, thus passing to the appellant her community interest in the estate free and clear of all of the community indebtedness." Of course, in the absence of a claim provable against the estate, as a matter of property law the question facing this Court did not arise.

All of the tax authorities agree that where, "under local law, a claim is both an obligation of the community as well

as a personal liability of the deceased husband, and it must be satisfied pro rata out of both shares to the extent that there are sufficient funds, no more than one-half is a 'personal obligation' of the decedent and hence only one-half is deductible." Mertens' Law of Federal Gift and Estate Taxation §26.20. See also Jackson, Community Property and Federal Taxes, 12 S.W.L. Jour. 43 (1958); Childress, Community Property in Administration of Estates in Texas, Tex. Inst., 5th Ann. Tax. Conf. (1957), 155, 167; Warren and Surrey, Federal Estate and Gift Taxation (1961), p. 710; Lowndes and Kramer, Federal Estate and Gift Taxes (1962), § 15.18, p. 347.

The executors find support for their position in two tax court cases dealing with funeral expenses: *Estate of McGargan*, 47 B.T.A. (1942) and *Estate of Bradley*, 12 P-H Tax Ct. Mem. 1195, CCH 2 TCM 609 (1943). These were Florida and Georgia cases; they did not involve community property. Besides, Stapf's funeral expenses are not at issue here; they were allowed as a full deduction. There is little or no analysis of the rationale for allowing the deduction in either case, other than the statement in *Estate of Bradley* that since the sums were actually expended by the executors and approved by the state court having jurisdiction, they were deductible. Such a statement is clearly incorrect. In *Fidelity-Philadelphia Trust Co. v. United States*, 3 Cir., 1955, 222 F. 2d 379, the Third Circuit held that executors' commissions were properly deductible only up to three per cent of the gross estate, even though the state orphans' court had allowed four per cent. "The fact that a

claim was presented and allowed in the probate court and subsequently paid by the executors has no bearing on the deductibility of the claim in question [in computing the net taxable estate]." *United States v. Mitchell*, 7 Cir., 1934, 74 F. 2d 571, 573; see *Estate of Schoenfeld*, 37 B.T.A. 36, 40 (1938).

The principles applicable to allowance of funeral expenses are completely inapplicable to allowance of debts or claims against the community. A claim for funeral expenses comes into existence *after* dissolution of the community. In *Blair v. Stewart*, 5 Cir., 1931, 49 F. 2d 257; *cert. den.* 1931, 284 U.S. 658, 52 S. Ct. 36, 76 L. Ed. 558, this Court, construing Texas law, held that funeral expenses, chargeable against "the estate" were chargeable against the only estate being administered, "the interest of the decedent in community property." Since that case, "it has been the uniform practice of examining revenue agents in Texas to allow all of the decedent's funeral expenses * * * as a deduction against the decedent's half of the community."[12] However, both courts and legislatures have stretched community property law in dealing with funeral expenses. Texas courts take the view that "a decent regard for the memory of the dead" warrants holding the community liable for funeral charges, and have expressly disapproved of *Blair v. Stewart*. *Norwood v. Farmers & Merchants National Bank of Abilene*, Tex. Com. App. 145 S.W. 2d 1100, 1103, *err. ref'd*; see also *Goldberg v. Zellner*, Tex. Com. App. 261 S.W. 801; *Richardson v. McCloskey*, Tex. Com. App. 276

[12]Childress, Community Property in Administration of Estates in Texas, Tex., Inst, 5th Ann. Tax Con. 155, 177 (1957).

S.W. 680; *Hocker v. Piper*, Tex. Civ. App. 2 S.W. 977; *Goggins v. Simmons*, Tex. Civ. App. 1958, 319 S.W. 2d 442.

3. *Tax Effects.* The subject of the federal estate tax is the transfer of economic interests. A decedent's assumption of the debts of another cannot change the total of the economic interests transferred. It can only divert part of the total by a legacy equal to the debts assumed.

Under the majority's holding, the rich and shrewd in a community property state can put the estate tax out of business. For example, in the twilight of their years, a couple with community property worth $1,000,000 could borrow an additional $1,000,000 and invest it in securities, using the $2,000,000 as collateral. As a result, the community property would be increased from one million to two million dollars, and would have debts against it of one million dollars. If the husband provided by will that all community debts be paid out of his share of the community property, upon his death his share of the community property would be worth $1,000,000. All of this, however, would be matched by deductible community debts. Thus, under the Court's holding, the entire "net" estate of $1,000,000 would pass, untaxed, to the wife.

If the majority decision is not corrected, the will of every informed taxpayer in all the community property states is certain to follow Stapf's will. Such taxpayers will enjoy a substantial advantage over taxpayers in common law states. With the same amount of property as that of a married couple in a common law state, a Texas widow's share of the

community will be larger than the marital deduction, to the extent of one-half of the debts. Judge Dooley pointed this out clearly, 189 F. Supp. 830, 834:

> "To say that a will with such provisions is effective under the law of Texas is not at all the same thing as saying that under the laws of the State of Texas, dealing with the allowance of claims in the course of probate and administration or in levying the state inheritance tax, the law puts the power in the hands of a testator at will to alter the amount of deductible debt obligations up or down, depending on whether the testator chooses to assume separately all of the community debts or prefers to let the survivor of the marital community bear one-half of such liability. The Federal Estate Tax Law was revised and altered materially in 1948 with the purpose of achieving approximate equality among taxpayers in community and non-community states. It is not readily apparent how a testator in a non-community state could very well duplicate the advantage sought in behalf of the present estate."

### D. Costs of Administration

The majority opinion does not differentiate between funeral expenses, administration expenses, and debts. Each of these, however, is a distinct category controlled by its own rationale in the determination whether it is chargeable to the decedent's estate or to the community. They cannot be lumped together. The official Interpretative Commentary to Section 322 of the Texas Probate Code, for example, states that funeral expenses, expenses of administration, and expenses incurred in the preservation, safekeeping, and management of the estate "are not debts of the decedent". As pointed out in this opinion, notwithstanding *Blair v. Stewart*,

supra, Texas courts treat funeral expenses as charges against the community.

If the husband should die first, half of the costs of administration are charged against his estate, because the entire community is included within the administration.[13] *Katherine Schumacher*, 8 T.C. 453 (1947). If the wife should die first, all of the expenses of administration are deductible because only her half of the community is administered in her estate. *Blackburn's Estate v. Commissioner*, 5 Cir., 1950, 180 F. 2d 952.

The district judge, as I see it, properly allocated 70 per cent of the expenses of the administration to the community, that is, 35 per cent to the widow's share and the 35 per cent plus the remainder of 30 percent to the decedent.[14] This seems a fair allocation. As noted by Judge Dooley, the ex-

[13] DeFuniak explains the reason for this:

"The fact that where the husband dies the administration of the community property should be separate and apart from, although inside, the administration of the husband's estate which is taking place, seems not always to be understood. It must also be remembered that, although such an administration of the community property is taking place in order to pay community debts and accomplish a partition, half of the community property so being administered belongs not to the deceased husband but to the surviving wife, and always belonged to her from the moment of its acquisition during the marriage . . . . [A]dministration of community property is a thing apart from ordinary administration, in that it is actually settling up matters relating to property which belongs in equal shares to the decedent's estate and to a living person and not merely the administration of property belonging entirely to the decedent's estate." 1 DeFuniak, Principles of Community Property, Dissolution of Marital Community, § 205, p. 585, 586.

[14] Perhaps a better rule would be to fairly apportion these expenses between the estate and the surviving spouse on the basis of the time and effort expended on behalf of each estate. The services of the executor, the attorneys and accountants in seeing that the debts are paid and in getting half of the community into the hands of the surviving spouse are of benefit to the survivor's estate and some portion of these expenses may be equitably chargeable to such survivor." Jackson, Community Property and Federal Taxes, 12 S.W.L.J. 1, 37 (1958).

ecutors spent a great amount of their time in connection with the administration of the community. There is no good reason for giving Mrs. Stapf a free ride.

### E. Conclusion

Strong economic, social, and moral reasons support the view that marriage is a full partnership between equal partners. Judge Dooley speaks for all of the traditional community states when he says, there is "a deep-rooted tradition . . . that liabilities against the whole community estate should be borne half and half, in the true spirit of the marital partnership." 189 F. Supp. 830, 835.

It is not easy to fit community property concepts smoothly into a tax system essentially derived from principles extracted from some sort of a "brooding omnipresence in the sky." As a consequence, for many years the integrity of the community property system as an institution was under almost continuous attack from taxpayers understandably resentful that citizens in common law states should pay higher federal taxes than citizens in other states. The attack reached its peak in the Revenue Act of 1942. This statute, ignoring the wife's vested ownership in community property and community earnings, treated her half as owned by the husband. The Act required the inclusion of the whole community in the taxable estate of the first spouse to die. The statute may have been motivated by ideals of tax equality and uniformity, it may have been grounded on sound tax arithmetic, but it struck a severe blow against what many persons regard as an enlightened concept of the

marital relationship and the status of married women. Finally, in the tax equalization provisions of the Revenue Act of 1948, after years of negotiation, a delicate but balanced reconciliation of interests was achieved by putting taxpayers in the common law states on the same paying basis as taxpayers in community property states "without tinkering with the property law of the states."[15] There are some who condemn the 1948 Act as not consistent with federal emphasis on control as the chief criterion in taxing, and as having generated new inequalities.[16] But the Act has saving graces. It works. The tax inequalities it created are relatively minor. In common law states the Act's reliance on check-book equality prevents any pressure from being exerted to introduce an alien legal institution. And, in community property states federal tax laws now no longer run counter to laws and customs long rooted in the civil law concept of the marital relationship as a partnership between husband and wife.[17]

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[15]Beveridge's phrase. Beveridge, 2 Law of Federal Law of Estate Taxation 181 (1956).

[16]See Surrey, Federal Taxation of the Family—The Revenue Act of 1948, 61 Harv. L. Rev. 1097 (1948); Anderson, The Marital Deduction and Equalization under the Federal Estate and Gift Taxes Between Common Law and Community Property States, 54 Mich. L. Rev. 1087 (1956). DeWind, The Approaching Crisis in Federal Estate and Gift Taxation, 38 Cal. L. Rev. 79 (1950). See also Memorandum Submitted by the Secretary of Treasury to the Senate Committee on Finance, March 1, 1948, Analysis of the Estate Gift Tax Provisions of H.R. 4790 (Revenue Act of 1948), reprinted in Warren and Surrey, Estate and Gift Taxation (1961). Lowndes and Kramer, Beveridge, and, not surprisingly, legal writers in the community states have found that after adoption of 1948 Act the sky did not fall. Beveridge, Law of Federal Estate Taxation, Chap. 14 (1956); Lowndes and Kramer, Chap. 17 (1962). See Thurman, Jackson, Riehm, Nossaman, and Ray, cited in notes 17 and 18. See also Golden, A Decade with the Marital Deduction, 97 Trusts and Estates, 304 (1958).

[17]See Thurman, Federal Estate and Gift Taxation of Community Property, 1 Ariz. L. Rev. 253 (1959); Jackson, Community Property and Federal Taxes, 12 S.W.L.J. 1 (1958). Riehm, The Impact of Community Property Law on Federal Taxation, 4 S.W.L.J. 161 (1950).

This decision imperils the tax reconciliation between the States. The irony of it is that in the name of Texas and taxes, the holding egregiously offends Texas law and tax law.

## II. The Marital Deduction.

The election device, borrowed from the common law and an anomaly in a community property system, enables a testator to exchange a marital bequest for the power to dispose of his widow's share of the community over which, by law, he has no testamentary control.[18] The usual transaction is three-cornered, since the widow's property passes not to or through the estate but to a trust. Here, as a result of his widow's election, Lowell Stapf *increased* the amount of the property he controlled in his will.

The purpose of the marital deduction is to give to taxpayers in common law states the same tax benefits from a marital bequest that a surviving spouse has from her share of the community. To round it out, taxpayers in community property states are allowed a marital deduction up to one-half of the amount of the separate property.[19] The Act has

[18]For discussion of the Widow's Election and the Marital Deduction, see Ray, The Widow's Election—A Study in Three Parts, 15 S.W.L.J. 85 (1961); Westfall, Estate Planning and the Widow's Election, 71 Harv. L. Rev. 1269 (1958); Brown, The Widow's Election as a Tax Savings Device, 96 Trusts and Estates 30 (1957); Brookes, The Tax Consequences of Widows' Elections in Community Property States, U. So. Cal. 1951 Tax Inst. 83; Nossaman, Trusts Under The Revenue Act of 1948, U. So. Cal. 1950 Tax Inst. 459.

[19]This is not a deduction for bequests of separate property, as such. Aside from the effect of community property on the computation of the maximum allowable marital deduction, there is no difference pertinent here between community property and separate property. Community property may qualify for the marital deduction. However, the amount of the decedent's interest in community property must be subtracted (along with deductions for administration expenses and claims against the estate) from his gross estate to arrive at an "adjusted gross estate". Section 812(e)(2)(B), Code of 1939. The marital deduction cannot exceed 50 per cent of this adjusted gross estate. Thus, the amount of the marital deduction is limited or determined by the amount of separate property.

two built-in requirements integral to a bequest qualifying as a marital deduction: (1) *There must be no strings.* The surviving spouse to whom the bequest is made must be given rights substantially equivalent to the absolute rights a surviving spouse has in her share of the community. This is the price the husband pays to obtain the marital deduction. (2) *The property bequeathed must be includible in the widow's taxable estate* or must be subject to a gift tax on its disposition by gift, that is, taxed again in the same generation. This is the price the widow pays to obtain the marital deduction. These requirements tend to offset a large loss of tax revenue, taking into consideration the frequency with which persons of means would otherwise avoid taxation of a widow's estate by means of a testamentary trust with the income for life to the widow and the remainder to others. The marital deduction was sold to Congress and bought by Congress on these representations. The purpose and rationale of the Act, therefore, override the language. This is no place to bow down before literalism.

Here, it is just not a fact that Mrs. Stapf had the same rights to the bequest that she had over her community property. A survivor's ownership of a half interest in community property is absolute, unburdened, vested from the moment of the community's acquisition of the property. On the other hand, here the marital bequest was conditional and burdened with the obligation of the widow's giving up more than she received. The testator failed to pay the price he is required to pay for a marital deduction; the string he attached en-

abled him to control equivalent property, so that for all practical purposes, the property was part of his disposable estate.

The surviving spouse also failed to pay the price tax Congress put on a marital deduction: The bequeath did not increase her taxable estate by the amount of the property bequeathed. On the contrary, her taxable estate was reduced, since the value of her interest in the community, which she relinquished, exceeded the value of the bequest. She received no economic benefit from the bequest—except the tax savings. Moreover, she owed no gift tax, because she surrendered more than she received.

After the dust settled, the economic result of this transaction was a gift by the testator of $106,268.18 to the trust, and a gift by the wife of $5,174.50 to the trust. There was, therefore, no gift *to the spouse*. This is fatal to the executors' contention. The marital deduction is concerned only with a gift to a spouse. The Act is concerned with the economics of the transaction, as is evident from the fact that in determining the value of a bequest, "where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent . . . such incumbrance or obligation shall be taken into account". When the dollar-effect is a minus $5,000 result for the widow, it is unreal and obfuscatory to speak of the bequest as a gift to the spouse entitling the testator to a marital deduction.

The proper analytical approach, as I see it, is to recognize that we have a single three-cornered transaction involving

the husband (H), the widow (W), and the trust (T).[20] The bequest and the election cannot be separated and treated independently; the testator himself made that impossible. An example will clarify the approach, taking round numbers and changing the amounts so that they will be easy to follow. H dies, leaving $200,000 of separate property. The community amounts to $200,000. H's estate is $300,000; W's share of the community is $100,000. The will makes a bequest to W of $100,000 but puts her to an election requiring W to transfer her share of the community to T. W elects to take under the will, so her community interest of $100,000 goes to T. These are the economics: H has the same amount of property to dispose of as if he had made no bequest, $300,000, because of W's surrender of her property to H's testamentary control; W has the same amount of property, because the bequest of $100,000 is offset by the surrender of $100,000; T has $100,000 he did not have before. This is not my

[20]The approach we take is in keeping with Commissioner v. Siegel, 9 Cir., 1957, 250 F. 2d 339, affirming 26 T.C. 743 (1956). In that case the decedent's estate consisted entirely of community property. The husband's will created a testamentary trust with his widow as income beneficiary and his son as remainderman, and put his widow to an election. The basic question was whether the value of the gift is reduced by the value of the property received by the donor from a third person. The court considered it all one transaction and permitted the reduction. The surrender by the widow of her community property rights, in effect, was a gift to the estate of the decedent to the extent that the value of the interest surrendered exceeded the value of the interest received. The Court spoke of the transaction as "a contract supported by adequate consideration" and treated it as part gift and part exchange. To the same effect, see Chase National Bank, 25 T.C. 617 (1955), decided on other grounds, sub. nom. Commissioner v. Chase Manhattan, 5 Cir., 1958, 259 F. 2d 231.

I would distinguish Helvering v. Butterworth, 1933, 290 U.S. 365, 54 S. Ct. 221, 78 L. Ed. 365, on the basis of the difference between the Pennsylvania widow's dower-rights which had no value prior to her husband's death, and the Texas widow's interest in community property, which belonged to her prior to her husband's death and could be surrendered as the price of acquiring an interest in property which she did not heretofore own. See Brooks, The Tax Consequences of Widows' Elections in Community Property States, U. So. Cal. 1951 Tax Inst., 83, 88.

idea of the sort of a gift to a spouse that Congress had in mind when it enacted the marital deduction law.

Consider the tax effects, according to the majority holding. H would be entitled to a marital deduction of $100,000, bringing his estate down to $200,000. W owes no gift tax on the transfer to T, because the amount she transferred to T did not exceed the amount received. On W's death, there would be $100,000 only in her estate, if it were not consumed. Result, according to the majority: $100,000 escapes both estate and gift taxes. In 1948 the whisper of a rumor that the marital deduction might produce such a result would have torpedoed the Act.

In a common law state, the same result would be achieved only if the widow had property of her own. The scheme would have primary importance in a community property state because of the wife's ownership of half the community by operation of law. The majority's holding, therefore, tends to defeat the Act's purpose of placing all taxpayers on a par.

The result the majority reach is not dictated by the statute. Section 812(e)(1)(E) provides:

> "(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purpose of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—
>
> "(ii) where such interest or property is incumbered *in any manner*, or where the surviving spouse incurs *any obligation imposed by the decedent with respect to the passing of such interest*, such incumbrance or obliga-

> tion *shall be taken into account* in the same manner as if the amount of a gift to such spouse of such interest were being determined."

If we give the italicized words a common sense meaning, we must take them to exclude the necessity that the obligation be a pecuniary obligation, such as a mortgage, attached directly to the property. "Any" incumbrance or obligation is broad enough to encompass the absolute obligation the decedent imposed here. See Ray, the Widow's Election, 15 S. W. L. J. 85, 141 (1961).

The Court subordinates the meaning of the section as a whole to a literal interpretation of "gift" in the final clause: the obligation shall be "taken into account in the same manner *as if* the amount of a *gift* to such spouse were being determined". But, as in any "as if" situation, the very use of those two little words is implicit recognition that the thing treated "as if" it were the same is not the same. Some allowance, therefore, must be made for the lack of sameness where, for example, it would be inconsistent with the purposes of the legislation to treat the bequest here exactly as a gift. A bequest cannot be treated for all purposes as a gift; it is a testamentary disposition and the estate tax is involved.

The majority start with the premise that a marital bequest must be given the identical tax treatment as a gift. They point then to the unquestioned fact that in determining the taxability of a gift, a condition that the donee transfer a portion of her property to a third person does not reduce the value of the gift. The consideration must benefit the donor to relieve a transfer by him from being a gift. *Commis-*

*sioner v. Wemyss*, 1945, 324 U.S. 303, 65 S. Ct. 652, 89 L. Ed. 958. Since Mrs. Stapf's transfer went to the trust, not to her deceased husband, the majority hold that the value of the bequest was undiminished by the widow's election.

As pointed out, a view so literal defeats the purposes and rationale of the Act. On the other hand, if we bear in mind that in fact the bequest is a testamentary disposition, not an intervivos transfer,—the donor is deceased—it is constructive and in keeping with the intent of the Act to regard the bequest as a gift. We may accept the principle that in determining the value of a gift, benefits flowing to the donor, not detriment to the donee, is decisive. Here, then, to the extent possible and in the only way benefits may flow to a testator, Stapf received full consideration for his marital bequest by Mrs. Stapf placing her property within his testamentary control.

Wemyss is no obstacle to this approach. In that case the husband made an ante-nuptial transfer to his wife to compensate her for the loss of income from a trust established by her first husband; on her remarriage the income was to go to her child. This was held to be a taxable gift. But the donor in Wemyss, unlike the donor here, received no offsetting consideration or benefits from the immediate donee. Looking at the economic effects of the tripartite transaction in Wemyss, the husband made a gift to his wife's child, the income beneficiary of the trust. Wemyss, therefore, supports the argument I make here. In Wemyss, as in this case, because of the triangular nature of the transaction, the transferor made a

taxable transfer that, in effect, was a gift to a third person, not to the spouse.

This brings us back to the dominant statutory intention to provide a tax deduction for a non-community property taxpayer making a gift to his surviving spouse equatable with the widow's half of the community. To the extent it is a gift to the spouse, after taking into account all obligations imposed by the decedent, it qualifies for the marital deduction. If, instead, the testator uses his widow as an interposed party to make a gift to a third person the transfer to the spouse cannot be regarded as a gift to her. Thus, Lowndes and Kramer take note of the district court's holding in the case before us but nonetheless say:

> "[W]hat the Regulations are driving at seems to be this. If a decedent bequeaths property to his wife in lieu of her interest in community property, which is not part of his estate and which does not pass to her from him, it seems clear that the only thing which the surviving spouse actually receives from the decedent is the excess of the interest bequeathed to her over and above the value of her interest in the community property. *Therefore, this should be the only amount which qualifies for the marital deduction*". Lowndes and Kramer, Federal Estate and Gift Taxes, § 17.5 (1962).

The statute does not refer to the effect of a widow's election. Moreover, the terms "incumbrance", "obligation", and "taken into account" are imprecise. See 4 Mertens, Federal Gift and Estate Taxation § 29.53 (1959). It is especially appropriate, therefore, for Treasury to issue Regulations and for courts to give weight to the administrative interpretation of these terms.

Example (1) of Section 81.47c(b) of Treasury Regulations 105 is no different from the instant case.

> "(1) A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000."

Example (3) of the Regulation provides for just such a contingency as has arisen here:

> "(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife."

The Supreme Court has "many times declared that Treasury Regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons." *Commissioner v. South Texas Lumber Co.*, 1948, 333 U.S. 496, 501, 68 S. Ct. 695, 92 L. Ed. 836. I do not see any basis whatsoever on which the regulation governing marital deductions could be called "unreasonable and plainly inconsistent with the revenue statute".

I would hold that when a testator burdens a marital bequest with the condition that his widow surrender her property to his testamentary control the condition is an "incum-

brance" or "obligation" within the meaning of the Act. To the testator who is given power over property not otherwise within his testamentary control and to the spouse, the realities of the situation command recognition of the fact that the value of the bequest is the value of the property bequeathed over the value of the property surrendered by the surviving spouse. If the surviving spouse is worse off, this Greek-bearing-gifts bequest cannot qualify as a marital deduction, the justification for which is a no-strings spousal gift equivalent to the absolute ownership a surviving spouse has in the community.

I would AFFIRM the district court on the first point and REVERSE the district court on the second point.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

On Consideration Whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part and reversed in part in accordance with the opinion of this Court; and that this cause be, and it is hereby, remanded to the said District Court for such other and further proceedings as may be necessary and which are not inconsistent with the opinion of this Court.

"Wisdom, Circuit Judge, Dissents."

September 26, 1962

DOROTHY ANN STAPF et al.

v.

UNITED STATES OF AMERICA

Civ. A. No. 2734
United States District Court

N.D. Texas

Amarillo Division.

Aug. 8, 1960.

DOOLEY, District Judge

## STATEMENT

Lowell H. Stapf, being a resident for many years in Texas, died testate on July 29, 1953, and his will was thereafter duly probated in Potter County, Texas. The executrix and executor (simply executors herein) named in said will, duly qualified and timely filed an Estate Tax Return and paid the federal tax on the estate as computed in such return. Some months later the executors were notified by the District Director of Internal Revenue that a deficiency had been assessed and was claimed, materially increasing the tax against said estate. The alleged deficiency resulted principally from increasing the reported value of real estate and business property, reducing by half the full deductions taken for community debts, apportioning administrative expenses and attorneys' fees, which had been taken as a full amount deduction, and the denial of a marital deduction claimed in the return. These points of contention will be taken up separately and more in detail later herein.

The executors paid the amount of the deficiency assessed, plus interest, and have brought this suit to recover the amount of alleged overpayment in the amount demanded and collected by the District Director of Internal Revenue over the lawful tax liability of the estate.

This case will be determined under the Internal Revenue Code of 1939, as amended.

## THE DECEDENT'S WILL

The most pertinent parts of the decedent's last will and testament will be dealt with in numbered sequence and are quoted or stated, as follows:

### I

"My estate consists of both separate and community property. It is my purpose, in making testamentary disposition of my estate, to dispose of my separate estate and to dispose of the entire community estate as though it were my separate property, and my wife is requested to take under this will and waive her right to one-half of the community property. In the event she does not elect to take under this will, then my interest in the community estate and my separate property shall be held by the trustees hereinafter appointed for the benefit of my children, other than Lowell H. Stapf, Jr., share and share alike, and my wife shall not receive any part of my interest in the community property or any interest in my separate property."

III

This section provides a pecuniary legacy and a bequest of certain machinist tools to the decedent's son, Lowell H. Stapf, Jr.

IV

"I give, devise and bequeath to my beloved wife, Dorothy Ann Stapf, our personal automobile and one-third (⅓) of all the residue of my estate remaining after the bequest to Lowell H. Stapf, Jr., above set forth, and the bequest to her of our personal automobile."

V, VI and VII

These sections devise and bequeath the residue of the decedent's estate to the executors in the capacity of trustees for the use and benefit of Lee Dale Stapf, Donald Eric Stapf and Sylvia Rose Stapf, children of the decedent and his widow, to be managed as three separate but equal trust estates, and give directions, confer powers and detail the duties of the trustees.

IX

This section appoints Dorothy Ann Stapf and B. T. Ware II independent executrix and executor of the will and estate of the decedent, they having been appointed trustees also as just stated.

XII

In this section the decedent directed his executors "to pay all and not merely one-half of the following debts and charges out of my one-half part and share of our community property and estate, to-wit: All funeral expenses; all costs of administration incurred in connection with the administration of my estate, or as the result of my death, including, but not limited to, costs of court, attorneys' and accountants' fees; all debts owing by me, whether community or separate, all federal estate taxes attributable to my estate, and all state inheritance taxes attributable to the bequests and devises herein contained in Sections III and IV."

The quoted provision next above is immediately followed by terms which forbid recourse to the testator's separate property for payment of the items enumerated above "unless and until my one-half share and part of all community property has been exhausted," and which also forbid recourse to his widow's part of the community property and estate for the payment of any such items "until and unless my one-half share and part of our community property has been first exhausted and then my separate property has been next exhausted, except as hereinafter provided in the event my wife, Dorothy Ann Stapf, elects not to take under this will." The next and last provision in said section of the will is that all of the property devised and bequeathed in Sections III and IV of the will shall be taken free of liability on the items presently named, "provided, however, that in the event my wife, Dorothy Ann Stapf, does not

elect to take under this will then one-half of all debts of my estate, funeral expenses and costs of administration shall be charged to the one-half share and portion of the community estate of my marriage with Dorothy Ann Stapf vested in the said Dorothy Ann Stapf in accordance with the laws of the State of Texas.

The widow elected to take under the said will.

## THE ISSUES

*Life Insurance*

The decedent, as insured, held three life insurance policies at the time of his death, all issued before the marriage of decedent and his surviving widow on December 22, 1945, each of the three for a face amount of $5,000.00, and at the time of his death the first was payable to his said widow, and each of the other two were payable to the widow and two of his children.

The premiums on the first policy were paid in the proportion of 16/20ths from his separate property before his said marriage and 4/20ths from the community property after his said marriage. The premiums on the second of such policies were paid in the proportion of 11/18ths from his separate property before his said marriage and 7/18ths from community property after his said marriage. The premiums on the third policy were paid in the proportion of 4/11ths from his separate property before his said marriage and 7/11ths from the community property after his said marriage. In the Estate Tax Return the three policies

were inventoried, but only on the basis of $2,500.00 for each policy and the stated reason was that the premiums thereon were paid from community funds of the decedent, but the examining officer of the Internal Revenue Service changed the amount to $5,000.00 for each policy, and the stated reason was that the policies were acquired prior to the marriage of decedent and his surviving spouse, therefore, the total amount was deemed includible in decedent's gross estate. Neither action was correct and, instead, the proper course is to allocate to the estate that part of the total insurance monies measured by the same proportion as the sum of the premiums paid from the decedent's separate estate, plus one-half of the premiums paid from the community estate bear to the total amount of all premiums paid.[1]

*Community Debts and Administration Expenses*

The Estate Tax Return reported community debts in the aggregate of $32,367.52. This was scaled down a half by the examiner and the reason stated was that one-half of such community indebtedness should be chargeable to the community estate share owned by the surviving spouse. The plaintiff's rejoinder is that the decedent's will, by a lawful provision, directed that all such indebtedness should be paid from the decedent's community property share, or, if necessary, from his separate estate. This poses a rather novel question. Article 4620, Vernon's Texas Statutes states

[1] Lang v. Commissioner, 304 U. S. 264; Berdoll v. Berdoll, 145 S. W. 2d 227; Jackson, "Community Property and Federal Taxes; Southwestern Law Journal, Vol. 12, pages 43-44.

that the community property of husband and wife "shall be liable for their debts contracted during marriage." This point is also echoed at more length in the authoritative decisions of the Supreme Court of Texas.[2] Section 812(b), Internal Revenue Code of 1939, permits the deduction of such claims against the estate "as are allowed by the laws of the jurisdiction * * * under which the estate is being administered." This statutory provision is subject to the further explanation in Treasury Regulations 105, §81.36, as quoted in the margin.[3]

The argument of plaintiffs that the direction in the decedent's will, purporting to shift the ordinary burden for half of the community debts from the widow's equal part of the community interest and concentrating all the indebtedness against the decedent's half of the community estate, sanctions the augmented debt liability in this case as a full legitimate deduction under the estate tax law is not a plausible stride. It will not do to say that a testator, at his own pleasure, may double the deductions by such a voluntary assumption as a testamentary device. For one thing, such a proposition would be in derogation of the federal statute and regulations which require that deductible debts must be personal obligations of the decedent at the time of his death. "If there be sufficient community property in the estate to

[2] Stone v. Jackson, 109 Texas 385, 210 S. W. 953

[3] "Claims Against the Estate
"The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, * * * and interest thereon which had accrued at the time of death. * * * Only claims enforceable against the decedent's estate may be deducted."

discharge the obligations here in issue, then no more than one-half can be termed personal obligations of the decedent."[4]

The reference in the federal statute, previously quoted, to "the laws of the jurisdiction", by fair intendment, means the statutory system for the administration of estates or for the levy of estate or inheritance taxes in the particular state. Of course, decisional law dealing with such statutes from a tax relevant standpoint would be a ruling factor too. There is no claim made here that there is any provision in the Probate Code or the inheritance tax statute of Texas which would confer the right of a testator to double in amount the statutory deduction for debts in a state community property inheritance tax proceeding, by a testamentary expedient, such as that here in question. Instead, the plaintiffs rely on some decisional law of Texas, recognizing the effect of testamentary directions of the kind being discussed in litigation between distributees and making proper accounting and adjustment of equities between the parties, but those cases are not deemed in point in the tax litigation.[5] There is no doubt that a testator may lawfully exercise selectivity among different portions or different devises and bequests of his estate and order an impact of liabilities resulting in disproportionate burdens, or even a total burden on the one hand and exoneration on the other, and that is true in respect to payment of taxes, even the

[4] Lang's Estate v. Commissioner, 97 F. 2nd 867, 871-2.

[5] Thompson v. Thompson, 236 S. W. 2d 779; Medlin v. Medlin, 203 S. W. 2d 635; Matthews v. Jones, 245 S. W. 2d 974.

Federal Estate Tax. In fact, plaintiffs have cited cases where such directions were given in respect to divers items, including such Estate Tax, but the distinction is that in none of the cited cases did the provisions of the will affect in the slightest the amount of such estate tax. To say that a will with such provisions is effective under the law of Texas is not at all the same thing as saying that under the laws of the State of Texas, dealing with the allowance of claims in the course of probate and administration or in levying the state inheritance tax, the law puts the power in the hands of a testator at will to alter the amount of deductible debt obligations up or down, depending on whether the testator chooses to assume separately all of the community debts or prefers to let the survivor of the marital community bear one-half of such liability. The Federal Estate Tax Law was revised and altered materially in 1948 with the purpose of achieving approximate equality among taxpayers in community and non-community states. It is not readily apparent how a testator in a non-community state could very well duplicate the advantage sought in behalf of the present estate. Actually, taking Texas alone, if this decedent had died intestate, no such benefit for the estate as that being dealt with could be claimed with any conviction for the estate.

It is noteworthy that for several years, 1942-48, the Federal Estate Tax Law was cast in the general pattern which in the typical case treated all the community estate as falling within the gross estate of the first dying member of the marital community for tax purposes, and during that time

the Legislature enacted a curious statute, which became Article 3683a of Vernon's Civil Statutes of Texas, and is quoted below.*

This short-lived statute reflected the deep-rooted tradition of the community property law of Texas that liabilities against the whole community estate should be borne half and half, in the true spirit of the marital partnership. In other words, the policy of the Federal Estate Tax Law at that time, in forcing the inclusion of the whole community properties against the first dying member for tax purposes struck a discordant note, clashing with the fundamentals of community property law, and the Article in question obviously was enacted to afford an equalizing remedy that would, after all, divide the burden half and half, unless the contrary was directed in the decedent's will. Of course, any such direction in a will of that spent interim would not have affected the amount of the estate tax.

Another obstacle is that the decedent's testamentary decision to take all of the community indebtedness as a liability alone against his part of the community estate and, if need be, his separate estate, lacks, at least as to many of

*"Whenever a Federal Estate Tax is collected under Section 811(e)(2) of the United States Internal Revenue Code, or any corresponding section hereafter enacted by the Congress of the United States, and such tax is measured in part by the value of the surviving spouse's interest in community property owned by the decedent and such surviving spouse at the decedent's death, the executors, administrators or personal representatives of the decedent, unless the decedent directs otherwise in his or her will, shall be entitled to recover from the surviving spouse such portion of the total federal estate tax paid under said Section 811(e)(2) as the net value of the survivor's interest in the community estate included in the decedent's estate in the computation of the federal estate tax bears to the net taxable estate."

This Article was repealed in 1955, upon the adoption of the Texas Probate Code, and such repeal is noted in §434 of said Code.

the debts, the requisites of a deductible claim, since it had no adequate and full consideration in money or money's worth. Whatever support such indebtedness has from the inception consideration accrued to the decedent and his widow equally in their marital community. The debts were the outgrowth of something antecedent and it would be unnatural to assume that his part of only one-half of the underlying considerations would be sufficient as a full and adequate justification to match his declared purpose to take over all of the liability evidenced by said debts. The particular nature of such antecedent considerations will be stated more definitely later in this opinion.

Then there is the more comprehensive, and also valid, argument of the defendant to the effect that the transfer of economic interests from the decedent is the event taxed under the Estate Tax Law, and since the decedent can transfer only that portion of his property remaining after the satisfaction of his personal liabilities and the expenses of administering the estate, a deduction is allowed for such obligations, which necessarily reduce the quantam of transferred property. Such is not the true case, however, where decedent in his will assumes the debts of another. The effect of such a provision, if executed, would not change, in the sense of the law, the total property transferred by the decedent, but rather would only divert part of it by a gift equal to the amount of the other's assumed debts.

The above has not been said unmindful that some cases can be cited for the viewpoint that the consideration required to support certain deductible claims under the Es-

tate Tax Law does not necessarily demand a consideration inuring directly to the decedent, but may be satisfied with other kinds of consideration connected with a transaction done in the ordinary course of business identified with some good common law consideration.[7]

The relevant part of the Internal Revenue Code of 1939, as amended, dealing with deductions for claims against the estate in computing the net estate for the purpose of taxation is copied in the margin.[8]

The point might be raised that a sufficient consideration exists in the present instance referable to the widow's election under the will of the decedent, resulting in her acceptance of a disparity in consideration, or, in other words, a detriment because the one-third residuary interest she took under the will was worth moderately less than the value of the one-half community interest she yielded. This was an inter-family transaction, non-commercial in nature, and to approve its effectiveness as a basis for the deduction of all the community indebtedness against the decedent's

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[7]Carney v. Benz, Exec. 90 F. 2d 747; Commissioner v. Bryn Mawr Trust Co., Ex'trs. 87 F. 2d 607. The reverse also has been held. Latty, Exec. v. Commissioner, 62 F. 2d 952.

[8]Title 26, §812.

"For the purpose of the tax, the value of the net estate shall be determined, in the case of a citizen or resident of the United States, by deducting from the value of the gross estate.—

* * *

(b) expenses, losses, indebtedness, and taxes. Such amounts

* * *

(3) for claims against the estate,

* * *

The deduction herein allowed in the case of claims against the estate, unpaid mortgages, or any indebtedness shall, when founded on a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth; * * * *."

estate would seem repugnant to the purpose and policy of the Estate Tax Law.[9]

In any event, apparently the Supreme Court has substantially settled the matter in the case of Taft, Exec. v. Commissioner, 304 U. S. 351, where the decedent in her lifetime promised educational institutions to establish an endowment fund and to pay salaries of orchestral musicians and a director of art, which were accepted and acted on by the institution, thus becoming a binding obligation against the estate under the state law, then the executor claimed a deduction for the amount payable under said promises, as being deductible claims, and the conclusion of the Court is reflected in the extract from the opinion quoted below.[10]

[9] "Deductions based on promises that run to and benefit members of the decedent's family, however, might well defeat the very purpose of the deduction section, which was to preclude family contracts and similar understandings made as a cloak to cover gifts or testamentary dispositions." MERTENS Law of Federal Gift and Estate Taxation. Vol. 1, §5.13, pp 297-8.

[10] "The claims against the estate were not incurred or contracted for an adequate and full consideration in money or money's worth within the meaning of the statute. The terms used, the legislative history of the section, and the regulations interpreting it, require this conclusion. The conditions imposed by the decedent as to the expenditure of the money promised and the stipulation on the part of the payee to expend it in that fashion, or its compliance with the conditions, do not constitute an adequate or a full consideration in money or money's worth within the meaning of the Act. If there were doubt about the matter, the legislative history of the statute and the Treasury regulations would require us to so hold. The Revenue Act of 1916 permitted the deduction of the amount of claims against the estate 'allowed by the laws of the jurisdiction * * * * under which the estate is being administered.' The Acts of 1918 and 1921 contain like provisions. Under these Acts the claims in question would have been deductible as enforceable by state law irrespective of the nature of the consideration. The Act of 1924 altered existing law and authorized the deduction of claims against an estate only to the extent that they were 'incurred or contracted bona fide and for a fair consideration in money or money's worth.' Congress had reason to think that the phrase 'fair consideration' would be held to comprehend an instance of a promise which was honest, reasonable, and free from suspicion whether or not the consideration for it was, strictly speaking, adequate. The words 'adequate and full consideration' were substituted by §303(a)(1) of the Act of 1926. There must have been some reason for these successive changes. It seems evident that the purpose was to narrow the class of deductible claims and we are not at liberty to ignore this purpose."

The principle of the Taft case has been followed with effect in the Court of Appeals for the Fifth Circuit.[11]

It follows that the claim made for deduction was properly disallowed to the extent of the one-half part chargeable to the widow's portion of the community estate. Neither counsel has submitted any decision by either the federal courts or the former Board of Tax Appeals or the present Tax Court, which is exactly parallel to this case, but even if it be a controversy of first impression, the proper disposition of it seems well foreshadowed by the authorities already mentioned, and there is also some supporting persuasiveness in other somewhat analogous decisions.[12] Moreover there is the rule that provisions for deductions which lighten the impact of a taxing statute should not be strained to find an allowable deduction.[13]

Next, attention will be turned to the subject of administration expenses, including attorneys' fees. In this estate the amount incurred and paid under above item was $4,073.47. On review, the Examiner prorated the sum by the ratio of 65% allocated to the estate and 35% allocated to the widow's one-half of the community estate. It is quite elementary under the community property system, as known

[11]Ensley v. Donnelly, 190 F. 2d 59.

[12]Parrott v. Commissioner, 30 F. 2d 792; Estate of George Herbert Atkins, Exec. v. Commissioner, 2 T. C. 332, 346-7; Estate of Herbert A. Schoenfeld, Administrator de bonis non, cta., v. Commissioner, 37 B. T. A. 36; Towner v. Commissioner, 182 F. 2d 903; Estate of Mrs. Matney Dyer Lucey, Exec. v. Commissioner, 13 T. C. 1010, 1018-9; United States v. Mitchell, 74 F. 2d 571; Fidelity-Philadelphia Trust Co. v. United States, 222 F. 2d 379.

[13]New Colonial Co. v. Helvering, 292 U. S. 435; Empire Trust Co. v. Commissioner, 94 F. 2d 307.

in Texas, that the wife from the outset owns a vested one-half interest in the community estate. The death of this decedent dissolved the community relationship and his widow's part of the community estate became her own exclusively and in absolute severalty of title, yet nevertheless remained liable on community debts. Her election to take under the decedent's will did not make her property a part of the decedent's estate, but by her consent it only became subject to disposition under the terms of the decedent's will. In other words, the identity of her former interest in the community estate, which had become her separate and exclusive property, was not lost with respect to liability for community obligations and for that purpose was rightfully administered along with the decedent's separate and community property by the executors named in his will. So far as the record shows such combined administration in this instance was not merely perfunctory. A fairly large sum of debts, chiefly taxes, including the major item of some $25,000.00 owed as income taxes and interest for 1951, had to be paid. The other listed debts were accounts owed to merchants, utilities, an insurance agency and a physician. Then, of equal importance, the largest single asset of the estate being administered was Globe Foundry & Machine Company, finally valued at $87,710.80, which was described in the Estate Tax Return as a "going business". This evidently required active administration. The executors qualified in August 1953 and filed the Estate Tax Return in October 1954, and it is understandable from the circumstances of this record that their duties may well have re-

quired rather active attention from the executors. They had need also for advice and services of legal counsel. The business of liquidating the community debts and the conservatory function in regard to the going business aforesaid were of concern and interest affecting the widow's one-half of the original community estate. In making the apportionment for the administration expenses, including attorneys' fees, the Revenue Examiner evidently derived the fractions by a computation that showed the aggregate of the decedent's separate property and his portion of the original community estate comprised 65% of the total separate and community property owned by him and his wife at the time of his death.

This apportionment is found to be justified as fair and reasonable and will be sustained.[14]

*Marital Deduction*

The plaintiffs in Schedule A, Real Estate of the Estate Tax Return, listed three business lots as separate property of the decedent, valued at $40,000.00, and in Schedule M claimed a marital deduction in the amount of $13,333.33, being the one-third interest therein attributable to the like fractional interest devised by the decedent to his widow. The Examiner raised the value of said property to $65,000.00 and, at the same time, struck out said particular marital deduction sought by plaintiffs, but instead allowed a marital deduction in the sum of $9,033.33, covering the

[14]Williams v. Howard, 31 S. W. 835; Norwood v. Farmers and Merchants National Bank, 145 S. W. 2d 1100; Goggans v. Simmons, 319 S. W. 2d 442.

amount of life insurance proceeds collected by the widow in the total of $8,333.33, and the value of the decedent's interest in the family automobile, being the additional sum of $700.00, which were treated as having passed to the widow outside of the decedent's will. The present issue is whether a marital deduction was erroneously denied in respect to the aforesaid real estate. This precise question here posed has no beaten track and calls for original determination. The position of the plaintiffs is that the devise of an undivided one-third part and interest in and to all the decedent's estate, both separate property and his one-half of the community property, necessarily included a one-third interest in the separate property real estate aforesaid, and that such interest obviously qualified for the purposes of a marital deduction. On the other hand, the Government contends that when the surviving widow elected to take under the will and relinquish her one-half interest and part of the community estate, she accepted an interest worth some less than what she relinquished and by this concatenation of circumstances wiped out any footing for a marital deduction in relation to the separate real estate of the decedent. To be more explicit, the contention is that what she received was worth $105,568.18 and what she relinquished was worth $111,442.68. Thusly, the Government seeks to uphold this factor in the total deficiency assessed against the executors.

The defendant first points out that preliminary to any advent of a marital deduction there must first be a transfer of property from the decedent to the surviving spouse,

which was includible in decedent's gross estate,[15] and such deduction, within the maximum limit[16] is allowable in an amount equal to the value of such transferred property, as provided by the statute already quoted in Footnote 15.

Next comes the critical part of the statute, Internal Revenue Code of 1939 §812(e)(1)(E)(ii), which reads as follows:

> "(ii) Where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

Here ends the statutory chronicle and next begins the handiwork of the regulations.[17]

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[15]Internal Revenue Code of 1939, §812(e)(1)(A)

"For the purpose of the tax the value of the net estate shall be determined in the case of a citizen or resident of the United States, by deducting from the value of the gross estate—

* * *

(e) Bequests, etc. to surviving spouse

(1) Allowance of marital deduction—

(A) In General. An amount equal to the value of any interest in property which passes, or has passed, from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate."

[16]Internal Revenue Code of 1939 §812(e)(1)(H).

[17]Internal Revenue Code of 1939 §812(e)(1)(H)

Treasury Regulations 105, Sec. 81.47c(b), dealing with the subject of the marital deduction, in various aspects, states in part that the statutory reference to the passing of a property interest subject to the imposition of an obligation by the decedent includes a bequest in lieu of the interest of his surviving spouse under the community property laws, and then illustrates that particular ruling, as follows:

* * *

"(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the state of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife."

Unless the illustration contained in the regulation just noted in the margin is a rational capsule of the underlying statute quoted above, there is no support for the Government's proposition. This illustration deals boldly with the interrelation of the marital deduction and community property, although nothing is said about community property in the specifically related statutory language. This is not to say that the Internal Revenue Code of 1939, in §812, is altogether silent in respect to community property, because such property is mentioned in that part of the section governing the computation of the adjusted gross estate, but is noticeably missing in that part of the section where the defendant plants its reliance for the authority of the quoted illustration published by the Commissioner.

Significantly, any reference to community property is likewise absent in the Senate Report No. 1013 on the Revenue Act of 1948, which was the origin of the presently pertinent provisions of §812 of the Internal Revenue Code of 1939, as amended, and the comment in that report directed to the very provision looked at by the regulation and illustration in question are here copied, as follows:

> "Clause (ii) of such Subparagraph (E) directs that in determining the value of any interest passing from the decedent to the surviving spouse, encumbrances or obligations shall be taken into account in the same manner as if the value of a gift to the spouse of the interest passing were being determined. This is a clarification which was not expressed in the Bill as passed by the House. If the decedent by his will leaves to his surviving spouse real estate subject to a mortgage (whether or not such mortgage was a personal liability of the decedent)

the value of the interest passing to the surviving spouse does not under this Section include the mortgage. If, however, the decedent by his will directs the executor to pay off the mortgage, such payment constitutes an additional interest passing to the surviving spouse. If the decedent bequeaths certain property to his surviving spouse subject, however, to her agreement, or a charge on the property for the payment of $1,000.00 to X, the value of the bequest (and, accordingly, the value of the interest passing to the surviving spouse) is the value reduced by $1,000.00, of such property." U. S. Congressional Service, 80th Congress, Second Session, 1948, Volume 2, pp 1163, 1227-8.

Such legislative declaration naturally has probative force to show that the intent of Congress, as equally well manifested in the words of the law, was to recognize certain contingencies which would be relevant to the value of property identified with the marital deduction. The contingencies pointed out in said Senate Report certainly would decrease pro tanto the equity value of the property in question, and Congress was concerned with guarding against a marital deduction based on an inflated valuation. The regulation and illustration already discussed distort the intent of the law and push things to an absurdity. The premise is that under the present will the widow, by electing to take under the will and relinquish her community interest, was a loser in the transaction. Even so, it is difficult to see what that has to do with the right of the plaintiff executors to claim the disputed marital deduction. Surely, the Government cannot mean to claim that because the widow was out more than she got that what she took under the will was worthless. This comes right to what

seems the fallacy in the position of the defendant because in talking about the value of the relinquished community estate an extraneous element is introduced. In the market place, the value of the property interest the widow acquired under the will would not depend in the least on what she gave for such property ownership. It would still be worth just as much as if she had acquired it at a bargain. In contract, if the interest going to her under the will of the decedent had been subject to a mortgage indebtedness, or an obligation in the nature of a charge to pay a given sum of money to some third person, such as were mentioned in the Senate Report, then, without doubt, such an item would be reflected as a minus factor in the valuation of the interest she took under the will, but that would be quite independent of whether she relinquished more or less than the value of the property left to her in the will. The defendant's contention is regarded as a compound of confusion and the regulations and accompanying illustration, against the background of this suit, are held to be an erroneous overgrowth of exposition.

The Government also has failed to come to grips with a latent quandary in the most prominent and explicit language of the governing statute, that is, the wording that "such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

The Gift Tax Regulation, applicable to this lawsuit, in directing how to make valuation of gifts, as to property like that in the present estate, prescribes that such value is the

price at which such property would change hands between a willing buyer and a willing seller.[18]

The best counterpart which comes to mind in keeping with the statutory injunction to proceed "as if the amount of a gift to such spouse of such interest were being determined" is, if it be said that in an inter vivos transaction, the husband Stapf made a gift to his wife comprising a one-third interest in his whole estate, of both separate property and one-half of the community holdings, subject to the understanding that his wife, in turn, would make a gift of all her part of the community property and estate in trust for the children named as beneficiaries of the testamentary trust in Stapf's will. This supposed transaction presumably would entail a taxable gift by Stapf under the case of Commissioner v. Wemyss, 324 U. S. 303. To carry the similitude along, it should be assumed that such inter vivos gift from husband to wife was some less in value than the value of the community property she transferred in trust for the children. It would seem self-evident under the willing seller and willing buyer test that such gift property, being put to sale would have sold for none the less and none the more because of the value that the wife parted with in relinquishing her one-half of the community estate. Of course, to achieve the nearest likeness between the fictional gift transaction and this actual estate transaction, the gift of the one-third interest in the one instance and the devise of the one-third interest in the other instance are matching features, and manifestly, no contention of empty tax liability

[18]Reg. 108, Sec. 86.19.

could be made from the standpoint of the donor by saying that the gift property had no net value to the donee.

The marital deduction was fashioned to achieve better geographical equalization between citizens of the community property states and the non-community property states in the impact of estate and gift taxes, and undoubtedly it is an intricate expedient. There are a few cases which have decided close questions on this subject and in each instance the court upheld the right to the marital deduction.[19] It is well to recur to the policy of the marital deduction. That policy rests on the anticipation that the property used for the marital deduction and passing from the deceased spouse to the surviving spouse, though exempted from any tax in the estate of the deceased spouse, gains only a respite and not absolution, as such property will augment the estate of the surviving spouse and utimately make its contribution under the Estate Tax Law, or else in the meantime under the Gift Tax Law. This sequence would not be defeated if the plaintiffs are upheld in respect to the rejected marital deduction in the present estate. The one-third interest taken by this widow under the will of her deceased husband is valuable property, and unless disposed of by gift earlier, or used for living needs, should in ordinary course of time, after her death, be reported and inventoried in the estate tax return of her estate. In addition she, by her election under the will, became liable for a gift tax on the disparity in value between this marital

[19] United States v. Crosby, 257 S. W. 2d 514; Wachovia Bank & Trust Co. v. United States, 163 F. Supp. 832; Gwinn, Administrator v. Commissioner, 25 T. C. 31.

deduction property and her relinquished one-half of the community property estate.

The very spirit aforesaid of the law is the plain key to the statutory direction for valuation of marital deduction property and particularly the provision that "where such interest or property is encumbered in any manner or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."[20] This bespeaks a studied purpose of the law to guard against the allowance of a marital deduction in a sum greater than the net value of the property involved. Thus, property worth $10,000.00, but encumbered by a mortgage debt of $1,000.00, if devised to a surviving widow, will not rate a marital deduction of $10,000.00. It should sell for $9,000.00 encumbered, or if the widow pays out $1,000.00 to discharge the debt, it then should sell for $10,000.00, but in either event, the widow's estate is only augmented by $9,000.00. The statute demands a matching valuation between the marital deduction and the constituent property and any marital deduction over $9,000.00 in the illustration used would violate the statute. The significance in this case of what has just been said is to point up how far afield things went in summoning the one-half community interest relinquished by the widow to demolish the marital deduction claimed by the plaintiffs. This brought into play an element having no connection with the purpose of the

[20]Internal Revenue Code of 1939, §812(e)(1)(E).

law as discussed above, and was wholly irrelevant. Indeed, such denial of the marital deduction runs counter to the law for the consequence would be to tax at this time the interest devised by the decedent to his surviving spouse and then tax it again in later years as a part of her estate and this would simply reverse the purpose of the law in providing for a marital deduction. The crucial mistake made in denying the marital deduction was the premise that the decedent's will imposed an "obligation" on his widow within the sense of the relevant statute last quoted above. In reality, the will only tendered an option. There was nothing predetermined. The most that can be said is that the will stated a condition, in contrast to the imposition of any pecuniary obligation annexed directly to the property devised to the widow. In other words, that did not subject the widow to an "obligation" in the sense of the law for the reason that to conclude otherwise would be entirely pointless to the purpose of the law as already brought out above.

The right of the case on this issue is with the plaintiffs. In fact, the defendant is in the vulnerable position of relying on a regulation which, as read by the defendant, would be out of step with the apposite statute and, actually, the very regulation did not foreshadow any such application as now urged by the defendant. The defendant's rule of diminishing marital deductions to the point of zeroing out any marital deduction would even outdo the conventional law of diminishing returns in the political economy field. At least, no such outcome is spelled out in the regulation in question.

A judgment is directed in conformity with the directions and terms of this opinion.

## GROSS ESTATE

"REGULATION 70, ARTICLE 10: Character of interests included. IX-33-4750 G.C.M. 7773

The husband, a resident of Texas, died leaving a will by which he devised to his wife and two children his entire separate estate together with the entire community estate owned by himself and wife. The wife elected to take under the will.

Held, that the interest which the wife has, under the laws of Texas, in the community estate is not a part of the deceased husband's gross estate within the meaning of section 302(a), Revenue Act of 1926, notwithstanding the wife elected to take under the will.

In the latter part of the year 1926, A, a resident of Texas, died testate, being surviving by his wife, B, and two children, C and D. At the time of his death A owned property which constituted his separate estate under the laws of Texas, and he and his wife, B, owned other property which constituted community property.

The pertinent provisions of A's will, in which he named B, C, and D as beneficiaries, are as follows:

I do hereby direct that all my just debts, funeral expenses, and expenses of my last sickness be paid by my executrix out of my estate as soon as practicable after my decease.

I do hereby give, devise and bequeath to the said B, my said wife, and to my children, C and D, share and share alike, all the rest and residue of my estate, real,

personal and mixed and of whatsoever kind and wherever situate, that I may own or in any way be entitled to or interested in at the time of my decease, including the entirety of the community property of myself and the said B, not merely my interest therein, and all my separate property and estate, to be theirs in equal shares in fee simple forever.

In the event the said B does not elect to take under this will, then I do hereby give, devise and bequeath all of my separate property and estate and all of my interest in the community property and estate of myself and my wife, B, to my children, C and D, share and share alike in fee simple forever.

B elected to take under the will.

The question presented is whether the interest which B had in the community estate under the laws of Texas and which was disposed of in the will is, under the provisions of section 302(a) of the Revenue Act of 1926, a part of A's gross estate.

A question similar to the one here involved was considered by the United States District Court for the Northern District of Texas in *Vincent v. United States* and *Underwood v. Reed.* The Vincent case was tried in the Fort Worth division, and judgment was rendered for the plaintiff on January 24, 1928. The Underwood case was tried in the Dallas division, and judgment was rendered in favor of the plaintiff on March 5, 1929. In each of those cases the court held without written opinion that the interest of the wife in the community estate was not a part of her deceased husband's gross estate. The Government did not appeal from those decisions.

In view of the court's decisions in the Vincent and Underwood cases, which are applicable to the instant case, it is the opinion of this office that the value of B's interest in the community property is not a part of A's gross estate within the purview of section 302(a) of the Revenue Act of 1926, notwithstanding the fact that she elected to take under the will.

All rulings of this office which are in conflict with this memorandum are hereby revoked.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue."